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7 **BOARD OF EQUALIZATION**
8 **STATE OF CALIFORNIA**

10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **HOWARD BRIEF¹**) Case No. 530872
13)

14
15 Year Proposed
16 2004 Assessment
17 \$182,673

17 Representing the Parties:

18 For Appellant: Howard Brief, Esq.
19 For Franchise Tax Board: Ciro M. Immordino, Tax Counsel III
20

21 **QUESTION:** Whether appellant was the owner of property such that he is entitled to like-kind
22 exchange treatment with respect to the property under Internal Revenue Code (IRC)
23 section 1031.²
24

25 ¹ Appellant resides in Orange County.

26 ² Although respondent assessed additional tax in part on a determination that appellant must recognize gain in connection
27 with his negative capital account and a portion of his itemized deductions should be disallowed, these items are wholly
28 dependent on a determination that HHB partnership owned the property at issue in this appeal. As stated by appellant, these
items would be moot in the event the Board determines that the property at issue was not owned by a partnership. (App.
Reply Br., p. 1.) Appellant does not otherwise contest these items. Accordingly, these items are not addressed in the hearing
summary.

1 HEARING SUMMARY

2 Background

3 This appeal concerns an individual deed owner of commercial real property purportedly
4 electing to make a tax-deferred like-kind exchange of property under IRC section 1031. The Franchise
5 Tax Board (FTB or respondent) disallowed the individual's like-kind exchange on the grounds that a
6 partnership, rather than the deed owners, owned the property and reported the gain from the sale, and
7 only the partnership is entitled to make a like-kind exchange.

8 On October 30, 1980, Jacqueline F. Miller executed a grant deed that conveyed to
9 appellant and IVP Investors, Inc. (IVP), a California corporation, each an undivided 50 percent interest
10 in commercial real property located at 909 Electric Avenue in Seal Beach, California (the Electric
11 property) for a selling price of \$700,000. (App. Reply Br., exhibits 1-2.) In conjunction with the
12 purchase of the Electric property, appellant and IVP executed a deed of trust and promissory note to Ms.
13 Miller for the balance owed on the purchase price, which was filed with the Orange County Recorder's
14 Office on December 22, 1980. (Appeal Letter, pp. 1-2, Resp. Opening Br., p. 2, exhibit D.) The deed of
15 trust lists the same address for appellant and IVP on Main Street in Seal Beach, which is a commercial
16 office. (Resp. Opening Br., p. 2, exhibit D.)

17 On February 18, 1981, a grant deed was filed in the Orange County Recorder's Office
18 that shows appellant and IVP transferred title to the Electric property to appellant, as to an undivided 50
19 percent interest, Thomas E. Hyams and Gloria D. Hyams, as joint tenants as to an undivided 38 percent
20 interest, and Michael T. and Kathy L. Hyams, as joint tenants as to an undivided
21 12 percent interest. (Resp. Opening Br., exhibit F.)³

22 At the time appellant and IVP acquired the Electric property, there was a single one-user
23 building at that location that they wanted to convert into a multi-use office building. (App. Reply Br.,
24 pp. 2-3.) To remodel the building, Seal Beach building codes required major changes, such as an
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26 ³ In the Appeal Letter and appellant's reply brief, appellant indicates that in February 1981, only IVP executed the deed
27 and his 50 percent interest remained the same. (Appeal Letter, p. 2, App. Reply Br., p. 2.) In his reply brief, appellant also
28 asserts that the February 18, 1981 grant deed conveyed an interest to the Hyams Family trust when in fact the grant deed
conveys an undivided 38 percent interest to Thomas E. Hyams and Gloria D. Hyams as joint tenants. (App. Reply Br.,
p. 2, exhibit 5.)

1 elevator and a central entrance with a staircase. (App. Reply Br., p. 3.) According to appellant, because
2 the deed owners were not able to pay for an architect for the remodel project, a local architect, Don
3 Hartfelder, agreed to do the remodel plans and oversee the construction in consideration for a three
4 percent interest in the Electric property. (*Ibid.*) In other words, Mr. Harfelder “agreed to defer his fee
5 for services.” (Appeal Letter, p. 2.) “Mr. Hartfelder never asked to be and has never been a deed holder
6 of record on the property[.]” (App. Reply Br., p. 3.) As discussed below, Mr. Hartfelder acquired three
7 percent of the sales proceeds when the Electric property was sold in December 2004. (Appeal Letter,
8 p. 3, Resp. Opening Br., exhibit OO.)

9 On October 7, 1982, appellant, Thomas E. Hyams, Gloria D. Hyams, Michael T. Hyams,
10 and Kathy L. Hyams, executed a construction deed of trust with Bank of America in order to finance the
11 remodel of the Electric property. (App. Reply Br., p. 3, exhibit 6.) The Electric property building was
12 ultimately remodeled into a medical and business office building. (Appeal Letter, p. 1.) Hyams
13 Commercial Leasing & Management, a management and leasing corporation owned by Thomas Hyams,
14 managed the building, rented offices in the building, collected rents, and paid bills incurred. (*Id.*, p. 6.)⁴
15 The corporation’s accountant prepared the required tax returns that allowed appellant to include the
16 building’s income and expense information on his individual tax returns. (*Id.*) According to appellant,
17 the corporation charged the deed owners a monthly fee for these services based on their respective
18 ownership percentages of the Electric property. (*Id.*)

19 In September 1986, appellant married Shannon C. Brief and he executed a quitclaim deed
20 for the Electric property to his spouse and himself, husband and wife, as joint tenants as to appellant’s
21 50 percent interest in the Electric property. (Appeal Letter, p. 2, App. Reply Br., exhibit 7.)

22 On April 6, 1994, Jacqueline F. Miller and the deed owners (appellant, Shannon C. Brief,
23 Thomas E. Hyams, Gloria D. Hyams, Michael T. Hyams and Kathy L. Hyams) individually executed an
24 agreement for the modification of the promissory note secured by a deed of trust on the Electric

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27 ⁴ According to respondent, Thomas Hyams managed the Electric property through approximately 1999 and his
28 management company, Hyams Commercial Leasing, managed it thereafter. (Resp. Opening Br., p. 16.)

1 property. (App. Reply Br., p. 4, exhibit 8.)⁵

2 When appellant and Ms. Brief divorced in March 1996 appellant's spouse executed an
3 interspousal transfer deed that conveyed sole ownership of the 50 percent interest in the Electric
4 property to appellant. (Appeal Letter, p. 2.)

5 On July 24, 2001, the deed owners (appellant, Thomas E. Hyams and Gloria D. Hyams as
6 trustees of the Thomas E. Hyams Family Revocable Trust dated April 30, 1991, Michael T. Hyams and
7 Kathy L. Hyams) individually executed a deed of trust, assignment of rents, security agreement and
8 fixture filing, as well as a promissory note with California Federal Bank, which permitted the deed
9 owners to pay off in full the promissory note owed to Ms. Miller. (App. Reply Br., p. 4, exhibits 9-10.)
10 Accordingly, title to the Electric property was held at that time by appellant, Thomas E. Hyams and
11 Gloria D. Hyams, Trustees for the Thomas E. Hyams Family Revocable Trust dated April 30, 1991, and
12 Michael T. and Kathy L. Hyams.

13 In December 2004, the deed owners individually sold their interests in the Electric
14 property to third party buyers pursuant to a grant deed dated September 14, 2004, which was signed by
15 the following grantors: (1) appellant; (2) Thomas E. Hyams and Gloria D. Hyams, Trustees for the
16 Thomas E. Hyams Family Revocable Trust dated April 30, 1991; (3) Michael T. Hyams; and (4) Kathy
17 L. Hyams. (Appeal Letter, p. 2; Resp. Opening Br., p. 9, exhibit QQ, App. Reply Br., p. 4, exhibit 11.)
18 Appellant sold his 48.5 percent interest in the Electric property in an IRC section 1031 like-kind
19 exchange,⁶ Michael and Kathy Hyams sold their 12 percent interest for all cash, and Thomas E. Hyams
20 and Gloria D. Hyams, Trustees for the Thomas E. Hyams Family Revocable Trust dated April 30, 1991,
21 sold their 36.5 percent interest on an installment contract by taking some cash and a trust deed and
22 promissory note from the buyer. (Appeal Letter, p. 4, Resp. Opening Br., p. 9, exhibits OO, RR.) At the
23 close of escrow, Mr. Hartfelder received three percent of the sale proceeds. (App. Reply Br., p. 3, Resp.

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25 ⁵ Thomas E. Hyams and Gloria D. Hyams apparently created a family revocable trust on April 30, 1991, which is not
26 reflected on the April 6, 1994 agreement for modification of the promissory note secured by deed of trust but is reflected in
later deeds of trust and escrow instructions, as discussed below. (See App. Reply Br., exhibit 9.)

27 ⁶ An addition and/or Amendment to Escrow Instructions dated December 16, 2004, clarifies that appellant for his 48.5
28 percent of the net proceeds shall enter into a "1031 tax deferred exchange." (Resp. Opening Br., exhibit RR.)

1 Opening Br., exhibit OO.)

2 On December 21, 2004, appellant executed an exchange agreement with Haven
3 Exchange and exchangor's instructions to Haven Exchange to affect the like-kind exchange. (Resp.
4 Opening Br., p. 9, exhibits SS, TT, App. Reply Br., p. 4, exhibit 12.) On June 21, 2005, Haven
5 Exchange purchased on behalf of appellant replacement property for purposes of the IRC section 1031
6 exchange. (Resp. Opening Br., p. 9.) According to appellant, "Due to existing economic conditions in
7 [sic] Orange County[,] the replacement property is now worth approximately \$350,000.00 less then [sic]
8 the purchase price of 2005." (App. Reply Br., p. 5.)

9 According to respondent, during at least the last 11 years the deed owners held title to the
10 Electric property, California partnership tax returns (Form 565) were filed listing the deed owners and
11 Mr. Hartfelder as partners of Hyams, Hyams and Brief (hereinafter referred to as the HHB partnership).⁷
12 Respondent states it has tax records for the HHB partnership from 1994 through 2004, which show a
13 partnership tax return filed each year. (Resp. Opening Br., p. 3.) Line I of the 2004 partnership return
14 indicates that it is HHB partnership's final California partnership tax return. (*Id.*, exhibit G, p. 1.) The
15 2004 partnership return includes on line D a federal employer identification number (FEIN), line E
16 provides that the partnership started business in California on January 1, 1981, and the Secretary of State
17 file number (GPGP) on line H indicates that the taxpayer was a general partnership. (Resp. Opening
18 Br., exhibit G, p. 1, Resp. Reply Br., p. 3.) Thomas Hyams signed the 2004 partnership return on behalf
19 of the HHB partnership, and Martin A. Menichiallo signed it as the paid preparer.⁸ (Resp. Opening Br.,
20 exhibit G, p. 1.) The 2004 partnership return states that the HHB partnership's sole asset was the
21 Electric property; it also lists cash and liabilities such as security deposits and mortgages in connection
22 with the Electric property. (Resp. Opening Br., p. 3, fn. 8, exhibit G, pp. 4, 7.) Schedule D-1 indicates
23 that the Electric property was sold on December 1, 2004. (Resp. Opening Br., exhibit G, p. 7.) The
24 2004 partnership return allocated net income and kept track of each partner's capital account as changed
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27 ⁷ It appears that a written partnership agreement was never drafted for the HHB partnership. (Resp. Opening Br., p. 3,
Appeal Letter, p. 4.)

28 ⁸ Respondent argues that during the audit at issue in this appeal, Thomas Hyams signed on behalf of the HHB partnership
an FTB power of attorney declaration (Form 3520) with the title "General Partner." (Resp. Opening Br., exhibit R.)

1 by each partner's share of partnership income, as well as capital contributions and distributions made
2 throughout the year. (*Id.*, pp. 8-15.) Schedule K-1s were attached to the 2004 return for each of the
3 following four listed partners: (1) appellant; (2) Thomas E. Hyams; (3) Michael T. Hyams; and (4) J.
4 Don Hartfelder.⁹ (*Id.*, pp. 8-15.) Appellant's Schedule K-1, which was attached to the 2004 partnership
5 return, shows on lines D and J(c) that appellant had 48.5 percent of the partnership income, which
6 amounts to \$1,672,990. (*Id.*, p. 8.) This sum¹⁰ consists of \$60,304 of net income from real estate
7 activities, \$58 of interest, and \$1,611,028 of net gain under IRC section 1231 (i.e., sale proceeds).¹¹
8 (*Ibid.*) Appellant's Schedule K-1 also shows on line J(e) an individual negative capital account of
9 \$341,007. (*Ibid.*)¹²

10 Appellant's 2004 California and federal individual returns were prepared by a certified
11 public accountant (CPA), Allan B. Chodor. (Resp. Opening Br., exhibit T, p. 2.) On Schedule E of his
12 2004 federal return, appellant reported in Part I (Income or Loss from Rental Real Estate and Royalties)
13 total rental income of \$34,210 from the commercial property where appellant's law office is located on
14 Main Street in Seal Beach, and on Part II (Income or Loss from Partnerships and S Corporations), he
15 reported passive income of \$60,304 from the Electric property. (*Id.*, p. 17-18.) Appellant did not report
16 any like-kind exchange on Form 8824 of his 2004 federal return. (Resp. Opening Br., p. 4, exhibit U.)

17 After the above-mentioned 2004 returns were filed, respondent determined that the 2004
18 HHB partnership return reported the sale of the Electric property but appellant failed to report his
19 portion of gain from the sale on his individual 2004 return. (Resp. Opening Br., p. 1.) Respondent also
20 determined that appellant failed to report gain related to his negative capital account of \$341,007 in the
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23 ⁹ According to respondent, Mr. Hartfelder must have become a partner of the HHB partnership sometime between 1981
24 and 1994 because the 1994-2004 HHB's partnership tax return transcripts show four partners. (Resp. Opening Br., p. 4, fn.
25 16, exhibit G-Q).

26 ¹⁰ Staff notes that this breakdown does not include \$1,600 of the \$1,672,990 in proceeds, an amount that staff has been unable
27 to determine.

28 ¹¹ According to respondent, the sales proceeds of \$1,611,028.00 includes cash proceeds of \$1,306,747.73, 48.5 percent of
the \$775,870.50 note paid off to the lender (Citibank), and 48.5 percent of other selling costs. (Resp. Opening Br., p. 9.)

¹² According to respondent, appellant's final capital account balance was a negative \$341,007. The partners, in total, had
negative capital account balances totaling \$699,508. (Resp. Opening Br., p. 10.) Staff notes that \$341,007 amounts to 48.7
percent, rather than 48.5 percent, of the partnership's negative capital account of \$699,508.

1 HHB partnership. (*Id.*, p. 10, exhibit G, p. 8.) Respondent thus increased appellant's taxable income
2 and reduced his itemized deductions due to additional phase-out of such deductions. (*Ibid.*)

3 Respondent issued its Notice of Proposed Assessment (NPA) on November 5, 2008,
4 which increased appellant's taxable income by \$1,963,167 from \$125,268 to \$2,088,435 due to the
5 disallowance of the like-kind exchange of \$1,611,028, the restoration of negative capital of \$341,007,
6 and the disallowance of itemized deductions of \$11,132 (i.e., \$125,268 + \$1,611,028 + 341,007 +
7 \$11,132 = \$2,088,435). (Resp. Opening Br., p. 1, exhibit A.) The NPA states that respondent stopped
8 charging interest beginning 18 months from the later of the original due date of the return or the date on
9 which appellant filed the return. (*Id.*)

10 Appellant protested the NPA. At the conclusion of the protest oral hearing, the protest
11 hearing officer agreed with the auditor's conclusion that the Electric property was owned by the HHB
12 partnership and therefore the like-kind exchange should be disallowed. (Resp. Opening Br., pp. 1-2.)
13 Based on this finding, respondent affirmed the NPA in a Notice of Action (NOA) dated April 2, 2010.
14 (*Id.*, exhibit B.) This timely appeal followed.

15 Contentions

16 Appellant's Contentions

17 Appellant argues that respondent erroneously determined that the like-kind exchange fails
18 solely because it was made on behalf of appellant individually. Appellant contends that respondent
19 concedes the proceeds from the Electric property properly went to an approved accommodator who sent
20 all proceeds to the escrow for the purchase of the replacement property, appellant did not receive any of
21 the sale proceeds, and all of the time requirements were satisfied. (Appeal Letter, p. 3, App. Reply Br.,
22 pp. 1-2.)

23 Appellant contends that IVP and he agreed to purchase the Electric property with the
24 following condition: "we would take title in our own names so that at any time either of us could
25 liquidate our [sic] interest without jeopardizing the position of the other owner." (App. Reply Br., p. 6.)
26 He also contends that neither IVP nor he "wanted to be locked into any arrangement that would require
27 the approval of the other owners." (*Ibid.*) Moreover, he contends that IVP and he "agreed that the
28 purchase would be a long term investment" and "[i]t was never intended to be a business nor did we

1 ever intend to become business partners.” (*Ibid.*) Appellant asserts that the deed owners held wholly
2 individual and divisible percentage interests in the Electric property, which could be sold or transferred
3 without the consent of the other deed owners. (Appeal Letter, p. 4.) Appellant also asserts that he
4 intentionally took title to the Electric property in his own name so that he could do what he wished with
5 the property without first obtaining anyone else’s permission. (*Id.*, p. 5.) He states, “My only
6 relationship with the other owners was to share the income and expenses of the property until I desired
7 to sell or trade it for other property.” (*Ibid.*) He contends that he decided to sell his interest in the
8 property at the same time as the other deed owners due to the timing of the sale and the selling price.
9 (*Ibid.*) He states, “If I had elected to retain my interest, which I had the absolute right to do, I would
10 have become an owner with the new buyer and each of us would have owned 50% free of any
11 obligations to each other.” (*Ibid.*) Appellant asserts that each of the deed owners sold their interest in
12 the Electric property separately: he sold his interest in a like-kind exchange, Michael and Kathy Hyams
13 sold their interest for cash, and Thomas and Gloria Hyams sold their interest on an installment contract
14 taking some cash and a trust deed and promissory note from the buyer. (*Id.*, p. 4.) Appellant states that
15 only Thomas and Gloria Hyams would have recourse against the buyer in the event the buyer defaulted
16 on the promissory note, “[t]he other owners would have no interest in the installment sale and if the
17 Hyams took back the property, they would become the sole owners.” (*Ibid.* See also App. Reply Br.,
18 pp. 9-10.)

19 Appellant asserts that the Electric “property was never an asset of any partnership and
20 was never owned by any partnership.” (Appeal Letter, p. 5.) He further asserts that during the time he
21 owned an interest in the property he neither treated it nor thought it to be a part of any partnership.
22 (*Ibid.*) Appellant argues that there was no partnership agreement and the owners “did not file the
23 necessary and required partnership fictitious business statement with the State of California[.]” (*Id.*,
24 p. 4.) Appellant further contends that “[n]one of the original 1980 purchase or escrow documents
25 indicated that a partnership was buying the property[.]” and “none of the 2004 sale or escrow
26 instructions/documents refer to a partnership or indicate that the property was being sold by a
27 partnership.” (*Ibid.*) See also App. Reply Br., p. 10.) He states, “[n]one of the sale proceeds were made
28 payable to a partnership entity or account.” (Appeal Letter, p. 4.) Appellant asserts that he had no prior

1 or subsequent business relationship with the other sellers of the Electric property, IVP was an additional
2 title holder on the Electric property, and he had no business or other relationship with Gloria Hyams,
3 Michael Hyams or Kathy Hyams. (*Id.*, p. 7.)

4 Citing California Corporation Code sections 16202, subdivisions (c)(1) & (2), and 16204,
5 appellant contends that very specific rules govern when property is deemed to be partnership property
6 and joint ownership of property by itself does not establish a partnership under California law, even
7 when “the co-owners share profits and returns made from the use of the property.” (Appeal Letter , pp.
8 4, 6.) Appellant also contends that all partnership agreements must “include binding provisions that any
9 partner wishing to sell must first offer [his or her] interest to the other partners before offering same to
10 persons outside the partnership.” (*Id.*, p. 5.) Appellant argues that title to the property controls whether
11 the property is partnership property or individual owners’ separate property. (*Id.*, p. 6.) Citing
12 *Magneson v. Commissioner* (1983) 81 T.C. 767, affirmed (9th Cir. 1985) 753 F.2d 1490, appellant
13 argues that the filing of partnership tax returns alone does not establish the existence of a partnership.
14 (*Ibid.*) Citing Treasury Regulation section 301.7701-3(a); *McManus v. Commissioner* (1975) 65 T.C.
15 197, aff’d (9th Cir. 1978) 583 F.2d 443 (*McManus*); and *ASA Investering Partnership v. Commissioner*
16 (D.C. Cir. 2000) 201 F.3d 505, appellant contends, “IRS filing rules and case law specifically allow joint
17 owners to file partnership tax returns to report income and expenses from jointly held property even
18 under circumstances where no partnership exists under state law.” (*Id.*, p. 6.)

19 In his reply brief, appellant contends that he “did not know any of the accountants nor
20 have any relationship with any of the accountants hired by Mr. Hyams.” (App. Reply Br., p. 6.) He
21 asserts that he had his own accountant for his returns. (*Ibid.*) Appellant also asserts that Mr. Hyams was
22 responsible for providing him with expenses and income information so he could give that information
23 to his accountant to use in preparing his individual returns. (*Ibid.*) Appellant contends that “[t]here
24 were absolutely no tax benefits realized by any of the owners by filing partnership returns and it was
25 never done to form a partnership.” (*Id.*, p. 7.) According to appellant, the preparation and filing of the
26 partnership returns were done “to provide an orderly and convenient method to record income and
27 expenses of the property and to be able to accurately allocate the information to each owner of the
28 building to include in their individual tax returns.” (*Ibid.*) Appellant asserts that neither he nor Mr.

1 Hyams “would have ever filed partnership returns if we had known the possible future ramifications at
2 the time we sold the building.” (*Ibid.*) Appellant also asserts, “We have now been informed “after the
3 fact” that we could have included the expense and income information on a Schedule E form in our
4 personal tax return and would not have needed a tax return for the building.” (*Ibid.*) (Underscore in
5 original.)

6 Attached to appellant’s reply brief is a declaration of Martin Menichiello. (App. Reply
7 Br., exhibit 14.) In his declaration, Mr. Menichiello identifies himself as a partner in the accountancy
8 firm known as Martin & Associates located in Huntington Beach, California, which was retained by
9 Thomas Hyams, the owner of Hyams Commercial Leasing & Management, in the past and up to tax
10 year 2004 to prepare the tax returns for the Electric building. (*Id.*, ¶¶ 1-2.) Mr. Menichiello also states
11 that the building on the Electric property was owned as tenants-in-common by appellant, the Thomas
12 Hyams Family Revocable Trust, and Michael and Kathy Hyams. (*Id.*, ¶ 3.) He further states that the
13 owners did not realize any tax benefit “in the filing of a partnership return and it was never the intention
14 of the owners to form a partnership.” (*Id.*, ¶ 5.) Moreover, Mr. Menichiello states, “It was determined
15 by the original accountancy firm that partnership returns would be prepared in order to have a more
16 convenient method to record the income and expenses of the property and allocate the information to
17 each owner to include in their respective individual tax returns.” (*Id.*, ¶ 4.) In addition, he states that he
18 “continued to prepare the same type of returns to maintain consistency in the filings.” (*Ibid.*)

19 Appellant states that the Hyams-Brief bank account at the Bank of America was opened
20 in 1982 as a sole proprietorship account using Thomas Hyams’s social security number. Attached to
21 appellant’s reply brief is a copy of the original signature card for the Bank of America bank account,
22 which authorizes the payment of funds with any of the following individuals’ signature: appellant,
23 Thomas E. Hyams, Kathy L. Hyams and Gloria Hyams. (App. Reply Br., p. 8, exhibit 15.) Appellant
24 asserts that he never signed a check on this account from the time it was opened in 1982 until the
25 account was closed after the sale of the building, which amounts to 22 years. (App. Reply Br., p. 8.) He
26 states, “Mr. Hyams or his wife transacted all of the business relating to the bank and the building as part
27 of their management duties,” and he has no information that the account was ever changed to a
28 partnership account. (*Ibid.*) According to appellant, none of the sales proceeds from the Electric

1 property were deposited in the Hyams-Brief bank account. (Resp. Opening Br., exhibit S, p. 3.)

2 As for the insurance on the building on the Electric property, appellant contends, “There
3 can be no argument that all of the insurance for the building was in the names of the record deed owners
4 individually[,] not a partnership.” (App. Reply Br., p. 9.) Appellant asserts that respondent admits in its
5 opening brief that the commercial umbrella insurance policy for the building and the business owner
6 protector insurance policy were in the names of the record deed owners individually as tenants-in-
7 common, rather than a partnership. (*Id.*, p. 8.) He further asserts that the insurance cancellation request
8 was completed in the names of the record deed owners individually, rather than a partnership. (*Ibid.*)
9 Attached to appellant’s reply brief are copies of the Declaration pages of the insurance policy, pertinent
10 pages of the Certificate of Insurance, and the Cancellation Request/Policy Release. (*Id.*, pp. 8-9,
11 exhibits 16-18.)

12 Appellant contends that all of the promissory notes that secured a monetary interest in the
13 Electric property were executed in the individual names of the deed owners, rather than a partnership
14 entity. (App. Reply Br., p. 9.) Appellant argues there is no merit to respondent’s contention that it must
15 be inferred that a partnership, rather than individuals, executed the promissory notes because the
16 ownership percentages of each person may not have been on all of the promissory notes. (*Ibid.*)
17 Appellant states, “If that premise is correct, what entity would the banks sue to regain their money upon
18 default[?]” (*Ibid.*) Appellant contends that only individuals signed the promissory notes and the banks’
19 only recourse would be against each individual who executed the notes. (*Ibid.*)

20 Appellant argues that respondent’s reliance on *McManus v. Commissioner, supra*, is
21 without merit. In that case, appellant asserts the taxpayers were long-time business associates in two
22 construction companies, the property was purchased, subdivided and held by the taxpayers primarily for
23 sale to customers in the ordinary course of their business, the taxpayers represented themselves to the
24 Internal Revenue Service (IRS) as a partnership, and they opened a partnership bank account. (App.
25 Rely Br., pp. 10-11.) In contrast, appellant asserts that he had no prior investment or business
26 relationship with the other property owners, they were never in business together, they did not buy the
27 Electric property to sell in the ordinary course of business, their purpose in buying the Electric property
28 was for a long-term investment, which in fact lasted 24 years, appellant has always denied the existence

1 of a partnership, and the bank account was opened by Mr. Hyams under his own social security number
2 as a sole proprietorship. (*Ibid.*) Appellant contends that the only similarity is that in *McManus, supra*,
3 and the present appeal partnership tax returns were filed for a period of time and title in the property was
4 held as tenants-in-common. (*Id.*, p. 11.)

5 Appellant also argues that the other major case respondent cited, *Demirjian v.*
6 *Commissioner* (1970) 54 T.C. 1691, affd. (3d Cir. 1972) 457 F.2d 1, is inapposite. (App. Reply Br.,
7 p. 11.) Appellant contends that in *Demirjian, supra*, the taxpayers were long-time business associates
8 and the sole stockholders in a corporation that owned and operated commercial rental properties as a
9 business, they dissolved the corporation, conveyed and recorded the property in their names as partners,
10 filed a Trade Name Certificate with the county clerk's office concerning their intent to transact business
11 as a partnership business entity, and they opened a partnership bank account and bought all of the
12 insurance for the properties in the name of the partnership business entity. (*Id.*, pp. 11-12.) In contrast,
13 appellant asserts that the Electric property was always a long-term investment, the ownership was
14 always held individually, no partnership documents or a fictitious firm name form was ever filed with
15 the Orange County clerk, the owners purchased the property insurance as individual owners, and the
16 bank account was opened as a sole proprietorship. (*Ibid.*) Appellant contends that the only similarity is
17 that in *Demirjian, supra*, and the present appeal partnership tax returns were filed for a period of time.
18 (*Id.*, p. 12.)

19 Appellant contends that respondent incompletely cited IRC section 761(a), which defines
20 the term partnerships. (App. Reply Br., p. 11.) According to appellant, respondent failed to include the
21 provision of IRC section 761(a) that provides under the regulations, the Secretary may exclude such
22 organization from the application of all or part of this subchapter, if the organization is for investment
23 purposes only and not for active conduct of a business. (*Ibid.*) Appellant asserts that his purchase of the
24 Electric property was for investment purposes only and it was not in the ordinary or active conduct of
25 his business as an attorney. (*Ibid.*)

26 Appellant argues that respondent is incorrectly basing its determination on one factual
27 aspect, the filing of partnership tax returns, whereas the totality of the circumstances, evidence and
28 accounts in this appeal establish that the parties had no intention to create a partnership and a partnership

1 never existed among the owners of the Electric property. (App. Reply Br., pp. 12-13.) Citing *In the*
2 *matter of Robert J. Ward and Nancy Ward* (1980) 6 B.R. 93, appellant contends that the most important
3 test in determining if an actual partnership relationship exists is the intention of the parties. (*Id.*, p. 13.)
4 Citing *Nelson v. Abraham*, 29 Cal.2d 745, appellant contends that the existence of a partnership or joint
5 venture investment is a factual issue for the trier of fact to determine based on the evidence and
6 inferences to be drawn from it. (*Ibid.*) Appellant asserts that the Supreme Court held in *Commissioner*
7 *v. Culbertson* (1949) 337 U.S. 733, that the existence of a partnership (or joint venture investment)
8 depends on whether “considering all the facts . . . the parties were acting with a business purpose
9 intention.”

10 Appellant also asserts that California Corporations Code section 16202 provides in part
11 that joint tenancy, tenancy-in-common, tenancy by the entireties, joint property, common property, or
12 part ownership does not establish by itself the existence of a partnership, even if the co-owners share
13 profits made by the use of the property. (*Id.*) Appellant further asserts that California Corporations
14 Code section 16204 provides very specific rules concerning when property is deemed to be partnership
15 property as opposed to being owned as the separate property of the individuals. Citing 3 Witkin,
16 *Summary of California Law* (7th ed.) pp. 2271-2272; *Detachable Bit Co. v. Timken Rolling Bearing Co.*,
17 (6th Cir. 1943) 133 F.2d 632; and *Tufts v. Mann* (1931) 116 Cal. App. 170, appellant contends that a
18 partnership ordinarily involves a continuing business, whereas a joint venture investment is usually
19 formed for a specific transaction. (*Id.*, pp. 13-14.) Citing Treasury Regulation section 301.7701-1,¹³
20 appellant argues the following: (1) a joint undertaking merely to share expenses does not create a
21 separate entity for federal tax purposes; (2) mere co-ownership of property that is maintained, kept in
22 repair, and rented or leased does not constitute a separate entity for federal tax purposes; (3) tax filing
23 alone does not establish the existence of a partnership; and (4) joint owners are allowed to file
24 partnership tax returns to report income and expenses from jointly-owned property even under
25 circumstances in which no partnership exists under state law. (App. Reply Br., p. 14.)

26 In his supplemental brief, appellant argues there is no merit to respondent’s attempts to
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28 ¹³ Appellant inadvertently refers to Treasury Regulation section 301.7701-1 as IRC Section 301.7701-1.

1 discredit the declaration of Mr. Menichiello because he is not a CPA and the website for Mr.
2 Menichiello's business, Martin and Associates, may be confusing. (App. Supp. Br., pp. 2-4.) Appellant
3 states, "No matter what the correct initials or designation may be for Mr. Menichiello and Martin and
4 Associates, the copy of their website attached to Respondent's brief states that they have been in
5 business preparing taxes since 1981 and are still in business." (*Id.*, p. 3.) According to appellant, "if
6 they were committing some sort of fraud on the public they would have been put out of business long
7 ago." (*Ibid.*) Appellant asserts that it never concerned him or the other owners of Electric property who
8 prepared the tax returns and what they called themselves. (*Ibid.*)

9 Appellant contends that respondent distorts the facts when it states in its reply brief that
10 partnership returns were first prepared for the Electric property in 1981 because respondent's opening
11 brief states that partnership returns had been filed since at least 1994 and likely as early as 1980. (App.
12 Supp. Br., p. 4.) Appellant states that respondent's opening brief "implies that there was no known
13 information regarding tax returns from 1980 to 1994." (*Ibid.*)

14 Appellant asserts that he is unable to understand respondent's argument that he realized a
15 tax benefit by filing a partnership return because he only paid taxes on a 48.5 percent ownership in the
16 building, he gave up some of his interest in the building, and he did not pay money for the architectural
17 services performed by Mr. Hartfelder. (App. Supp. Br., p. 4.) Appellant asserts that Mr. Hartfelder paid
18 taxes on his ownership percentage, appellant only owned 48.5 percent of the building, as reflected on the
19 K-1 forms he received each year, and appellant forfeited 1.5 percent of his interest in the building to Mr.
20 Hartfelder, which was worth much more than the money he would have paid Mr. Hartfelder in 1981 for
21 the architectural services. (*Ibid.*) Appellant states, "There is no doubt that because I could not afford to
22 pay for the architectural services with money I suffered a loss[,] not a benefit[,] by having to give up
23 1.5% of my ownership in the building." (*Ibid.*)

24 Appellant argues that the evidence discussed above establishes that the Electric property
25 was an investment, rather than a partnership used in the active conduct of a business relationship
26 between business-related owners. (App. Supp. Br., pp. 5-7.) Appellant states, "It suffices to say and the
27 evidence supports the fact that there was no prior or subsequent business relationship between the
28 owners of the property and that except for the filing of partnership tax returns, there was no other

1 incidents of ownership that one could have related to a partnership relationship.” (*Id.*, p. 5.) Appellant
2 again contends that respondent incompletely cites IRC section 761(a), which defines the term
3 partnerships. (App. Supp. Br., pp. 6-7.)

4 In his supplemental brief, appellant contends that respondent cannot rely on the duty of
5 consistency to disallow appellant’s like-kind exchange. Appellant asserts that the deed owners were not
6 aware of the duty of consistency, and, other than filing partnership returns, “this group of investors
7 followed the rule by being consistent in every other aspect of the ownership of the property.” (App.
8 Supp. Br., p. 8.) Appellant argues that there can be nothing more consistent than having the individual
9 names of the property owners, rather than a partnership, reflected on the purchase deed to the property,
10 all of the deeds of trust, all of the promissory notes, all of the insurance policies, the bank account, and
11 the sale and escrow documents. (*Id.*, p. 7.) He further argues that it was “consistent to report the
12 income and expense information on the partnership return and have it verified by the K-1 form in the tax
13 returns of the individual property owners.” (*Id.*, p. 8.) Citing Treasury Regulation section 301.7701-1,
14 appellant states:

15 It can not [sic] be disputed that a joint undertaking merely to share expenses does not create a
16 separate entity for federal tax purposes. Mere co-ownership of property that is maintained, kept
17 in repair, and rented or leased does not constitute a separate entity for federal tax purposes. **Tax**
18 **filing alone does not establish the existence of a partnership.** Joint owners are allowed to file
partnership tax returns to report income and expenses from jointly owned property even under
circumstances where no partnership exists under state law.

19 (*Ibid.*) (Emphasis and underscore in original.) Furthermore, appellant indicates in his supplemental
20 brief, which is dated December 15, 2010, that the IRS apparently agrees with his position because it has
21 “expressed no issue with my IRC 1031 like kind exchange.” (*Ibid.*)

22 Respondent’s Contentions

23 Respondent argues that appellant must recognize \$1,611,028 of sales proceeds from the
24 sale of the Electric property because the Electric property was sold by the HHB partnership, rather than
25 the deed owners, and appellant, a partner of HHB partnership, is not entitled to defer gain from the sales
26 proceeds under IRC section 1031. (Resp. Opening Br., p. 4.) Respondent asserts that appellant has been

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1 a practicing attorney since 1966, and owns his law office located on Main Street in Seal Beach.¹⁴ (*Ibid.*)
2 Respondent also asserts that a CPA prepared appellant's 2004 federal and California individual returns
3 and appellant signed them under penalty of perjury. (*Ibid.*) Respondent further asserts that appellant
4 reported on the 2004 federal return his income in connection with commercial real estate located on
5 Main Street on Part I of Schedule E and his income in connection with the Electric property on Part II of
6 Schedule E under "Income or Loss From Partnerships and S Corporations." (*Ibid.*) Respondent
7 contends, however, that appellant failed to report a like-kind exchange on Form 8824 of his 2004
8 individual tax return, which is required when a taxpayer elects to defer the recognition of gain through a
9 like-kind exchange. (*Ibid.*)

10 Respondent argues that appellant, Thomas Hyams, Michael Hyams and Mr. Hartfelder
11 conducted their activities in connection with the Electric property as a partnership. (Resp. Opening Br.,
12 p. 10.) Respondent contends that the Electric property was owned by the HHB partnership and the sale
13 proceeds were reported in the 2004 HHB partnership return. (*Id.* p. 17.) Respondent asserts that "upon
14 the sale of the Electric Property, all Partners received distributions in connection with their interest in
15 the HHB partnership, including Hartfelder; instead, of based on their interest in the deed to the Electric
16 Property." (*Id.*, p. 16.) Respondent thus concludes that appellant's claimed like-kind exchange cannot
17 be allowed because the HHB partnership sold the Electric property and appellant purchased the
18 replacement property in his individual capacity. (*Id.*, p. 17.) In determining whether appellant, a
19 California attorney since 1966, conducted the Electric property as a partnership, respondent asserts that
20 it is not necessary for appellant to understand the meaning of a partnership. (*Id.* p. 13.) Respondent also
21 asserts that "[e]ither the filing of partnership tax returns or the fact that Appellant reported income from
22 the Electric Property as if he were in a partnership is such a persuasive factor that either, alone, would
23 result in a determination that the HHB partnership existed and owned the Electric Property." (*Ibid.*) It
24 further asserts that "[a]lmost all of the remaining relevant facts are neutral or indicate that the HHB
25 partnership conducted the activities of the Electric Property." (*Ibid.*)

27 ¹⁴ This is the commercial property listed for purposes of reporting rental income on Schedule E of appellant's 2004 federal
28 return. (Resp. Opening Br., exhibit T, pp. 17-18.)

1 Respondent asserts that a bank account was maintained with Bank of America in the
2 name of Hyams-Brief for the operation of the Electric property business. (Resp. Opening Br., p. 6,
3 exhibit CC.) Respondent also asserts that this was the account to which the tenants wrote their rent
4 checks, the account that paid the bills, including the management fees paid to Thomas Hyams, and the
5 account from which monthly distributions were made to the partners, including Mr. Hartfelder, based on
6 their ownership interest in the HHB partnership. (*Id.*, p. 14.) Also, respondent asserts that the partners,
7 including Mr. Hartfelder, received a distribution from the remaining balance in the bank account upon
8 the termination of the partnership based on their pro rata ownership of the HHB partnership. (*Ibid.*)
9 Respondent states, “The fact that the flow of cash followed the Partners’ interests in the HHB
10 partnership and not the deed of the Electric Property is an important factor demonstrating that the
11 Electric Property was conducted through the HHB partnership.” (*Ibid.*) Respondent contends that the
12 total cash distributions the partners received from the Hyams-Brief bank account ties exactly to the
13 partners’ total cash distributions reported on the 2004 partnership tax return, and the 2004 partnership
14 return accurately reports the amount of cash distributed to the partners from the bank account. (*Id.*, p. 6,
15 14.)

16 Respondent contends that, although the Electric property’s insurance policy was issued in
17 the individual names of the deed owners as tenants in common, the partners, including Mr. Hartfelder,
18 paid the premiums based on their interest in the HHB partnership, rather than based on their ownership
19 interest in the Electric property. (Resp. Opening Br., p. 14.) Respondent further contends that the
20 insurance policies were taken out by the deed owners as a group and when two insurance policies were
21 cancelled, appellant and Thomas and Gloria Hyams signed on behalf of all of the deed owners. (*Ibid.*,
22 exhibits EE-HH) According to respondent, “For a tenancy in common, all Deed Owners should have
23 signed on behalf of themselves.” (*Id.*, pp. 14-15.)

24 According to respondent, there is a “common thread in this case,” which is that “the
25 activities of the Electric Property were conducted as a joint undertaking by the HHB partnership and was
26 therefore a partnership for tax purposes.” (Resp. Opening Br., p. 15.) Respondent contends that no
27 weight should be given to the fact that no partnership agreement existed between the partners, because
28 the partners’ actions indicate they were engaged in a joint activity. (*Id.*, pp. 15-16.) Respondent also

1 contends that the absence of a written management agreement with Thomas Hyams and Hyams
2 Commercial Leasing creates “the impression that the Partners were willing to do business without a
3 written agreement.” (*Id.* p. 16.) Respondent asserts that the deeds of trust and promissory notes related
4 to the Electric property indicate for numerous reasons that the partners undertook a joint venture. First,
5 respondent contends that the deeds of trust are often only sent to a single address on Main Street in Seal
6 Beach, rather than to the individual addresses of the listed owners. Second, rather than simply
7 transferring 12 percent of Thomas and Gloria Hyman’s 50 percent interest in the Electric property to
8 Michael and Kathy Hyams, the deed of trust, which appellant signed, transferred 100 percent of the
9 ownership interest, including appellant’s 50 percent interest. Third, the promissory notes for the Electric
10 property, which all of the deed owners negotiated and executed, list the grant owners as being jointly
11 and severally liable or include clauses that provide that the default of one grant owner would cause the
12 default of all grant owners. Fourth, with at least the most recent promissory note the payments were
13 made by all of the partners (including Mr. Hartfelder), rather than only the grant owners who executed
14 the promissory note. Respondent asserts that the circumstances behind the deed of trust do not support
15 appellant’s position because the partners as a group coordinated and negotiated the initial purchase, the
16 promissory notes, and the ultimate sale of the Electric Property. (Resp. Opening Br., p. 15.)

17 Respondent asserts that the management of the Electric property by Thomas Hyams and
18 his management company should be deemed a neutral factor because “it is common for management
19 companies owned by one or more partners or owners to manage property.” (Resp. Opening Br., p. 16.)
20 In the present appeal, however, respondent also asserts there are numerous factors related to the
21 management of the Electric property that indicates the existence of a partnership. First, the management
22 company was paid pro rata by the partners from the Hyams-Brief bank account, which demonstrates the
23 partners, rather than the deed owners, incurred the management expenses. Second, the tenants
24 reportedly knew Thomas Hyams as the owner who conducted the property’s everyday activities, rather
25 than as the manager. Third, the Electric property’s “tenants seemed to interact with Hyams-Brief,
26 instead of the management company, as the tenants’ lease agreements may have been with “Hyams-
27 Brief”, instead of the management company, and the tenant checks went to the Hyams-Brief bank
28 account.” (Resp. Opening Br., p. 16, exhibits AA, BB.)

1 Respondent contends the fact that Thomas and Gloria Hyams received part cash and the
2 remainder being a promissory note from the purchaser of the Electric property should be deemed a
3 neutral factor because it was simply due to the purchaser's inability to obtain adequate financing, which
4 could have occurred regardless of whether the Electric property was owned by a partnership or tenants
5 in common. (Resp. Opening Br., p. 16.)

6 Citing *Estate of Ashman v. Commissioner* (9th Cir. 2000) 231 F.3d 541, respondent
7 argues that under the duty of consistency doctrine, appellant is not allowed to argue that the sale of the
8 Electric property occurred in his individual capacity because he has a duty of consistency to report the
9 sale of the Electric property at the partnership level. (Resp. Opening Br., p. 17.) Respondent contends
10 that all three elements of the duty of consistency doctrine are met in this appeal. (*Id.* pp. 17-18.) First,
11 respondent asserts that for at least 11 years and likely for all 24 years in which he was involved with the
12 Electric property appellant represented that he was in a partnership by: (1) reporting the Electric
13 property and its related income, expenses, etc. on a partnership tax return and reporting such partnership
14 income, deductions, etc. on his individual income tax return as partnership items; (2) maintaining the
15 books as a partnership; (3) maintaining a partnership bank account; and (4) allocating the income,
16 deductions and other items from the Electric property among the HHB partners, including Mr.
17 Hartfelder, rather than among the deed owners. (*Id.*, pp. 18-19.) Second, respondent asserts that it
18 relied upon appellant's representations that he properly reported income based on his 48.5 percent
19 interest in the HHB partnership, rather than based on his 50 percent deed interest in the Electric
20 property. (*Id.*, p. 19.) Third, respondent asserts that it would be harmed by appellant claiming he held
21 the Electric property as a tenant in common, rather than as a partnership, because it would allow
22 appellant: (1) to avoid the recognition of gain from the sale through a like-kind exchange; (2) to avoid
23 1.5 percent of the income from the Electric property for many years; (3) to avoid gain from the sale of
24 the Electric property to Mr. Hartfelder; (4) to take excessive deductions on his tax returns; and (5) to
25 obtain benefits "by claiming the more favorable status of a partnership or tenant in common based on
26 what suits him best at the time." (*Id.*, p. 20.) Respondent further states:

27 Since all three elements of the duty of consistency are met in regard to the HHB partnership,
28 Appellant is estopped from arguing that the Electric Property is not in the HHB partnership. It is
important to note that even if the Electric Property was not in the HHB partnership, the duty of
consistency still estops Appellant from reporting that he owned the Electric Property in his

1 individual capacity as a tenant in common, and based on the duty of consistency the Electric
2 Property should still be found to be in the HHB partnership. This is the same outcome as in
3 *Ashman* where the taxpayer incorrectly reported that a portion of a payout was rolled over and
4 was later stopped from changing her prior incorrect statement. In accordance, Appellant must
5 recognize \$1,611,028 of sales proceeds in connection with the sale of the Electric Property as
6 reflected on Appellant's 2004 Schedule K-1 from the HHB partnership.

(*Id.* pp. 20-21.)

Respondent cites the following authorities as support for its position:

- 7 • In *McManus, supra*, three individuals purchased land as tenants in common, and between 1961
8 and 1973 improvements were made on the land and parcels were sold. Various financial
9 transactions recorded the land as an asset of the three named individuals and certain entries were
10 listed as "Drawing 3 partners" with pro rata amounts drawn among the three individuals. In
11 addition, the three individuals opened a joint bank account with the signature card showing the
12 three as co-partners, they filed partnership tax returns, and reported gains related to the land on
13 their individual tax returns. One of the individuals, McManus, made an election to defer the
14 recognition of gain with a like-kind transaction in his individual capacity, rather than as a
15 partner. The Ninth Circuit held that "[p]artnership for tax purposes is broader than common law
16 partnership." The court stated "that title to the land was taken as tenants in common is not
17 determinative since that may be considered neutral evidence." The Ninth Circuit affirmed the
18 tax court's determination that the IRS properly disallowed the deferral of gain because the three
19 individuals conducted their land business as a partnership. Citing *McManus, supra*, respondent
20 asserts, "Nonrecognition under IRC section 1031 will not be allowed if a partnership sold
21 partnership property and a partner purchased replacement property in their individual capacity."
22 (Resp. Opening Br., pp. 10-12.)
- 23 • In *Demirjian v. Commissioner, supra*, two taxpayers each owned 50 percent of a corporation's
24 stock. The corporation liquidated and deeded commercial rental real property to the taxpayers.
25 The taxpayers subsequently filed partnership tax returns, maintained capital accounts, reported
26 on the partnership tax returns the ultimate sale of the property, filed for a trade name, listed
27 themselves as partners in various documents, and kept a checking account for the business as
28 partners. The tax court disallowed the individuals' like-kind exchange on the grounds that they

1 were in a partnership. The tax court relied on Treasury Regulation section 1.761-1(a), which
2 provides that the term partnership for tax purposes is broader than the common law definition of
3 partnership. (Resp. Opening Br., pp. 11-12.)

- 4 • IRC section 761(a) provides that “the term ‘partnership’ includes a syndicate, group, pool, joint
5 venture, or other unincorporated organization through or by means of which any business,
6 financial operation, or venture is carried on.” (Resp. Opening Br., p. 10.)
- 7 • Treasury Regulation section 301.7701-1(a)(1) provides, “Whether an organization is an entity
8 separate from its owners for federal tax purposes is a matter of federal tax law and does not
9 depend on whether the organization is recognized as an entity under local law.”
- 10 • Treasury Regulation section 301.7701-1(a)(2) provides, “A joint venture or other contractual
11 arrangement may create a separate entity for federal tax purposes if the participants carry on a
12 trade, business, financial operation, or venture and divide the profits therefrom.”

13 In its reply brief, respondent argues that the declaration of Mr. Menichiello should not be
14 given persuasive value as to the purpose for filing partnership returns and whether appellant realized any
15 partnership tax benefits. Respondent asserts that Mr. Menichiello incorrectly claims that the partnership
16 returns were prepared merely for bookkeeping purposes. Respondent claims that there is a difference
17 between preparing and filing returns and fully-prepared returns are not required for bookkeeping
18 purposes. Respondent states that appellant attached his Schedule K-1 from the HHB partnership to his
19 individual return. By filing the returns under penalty of perjury, respondent contends that appellant and
20 the HHB partnership “held themselves out to Respondent and the Internal Revenue Service as a
21 partnership for income tax purposes.” (Resp. Reply Br., p. 2.)

22 Respondent also argues that it makes no logical sense for Mr. Menichiello to declare that
23 he continued the practice of filing partnership tax returns so as to be consistent with the incorrect filing
24 of partnership returns from prior tax years. Respondent contends there is no authority for filing
25 incorrect returns for the sake of consistency. Respondent also contends that the HHB partnership return
26 is not consistent with Mr. Menichiello’s declaration and, for the reasons described below, the
27 partnership returns were completed and filed in a manner consistent with a return reporting partnership
28 income, rather than merely for bookkeeping purposes. First, if a partnership was not intended to exist, a

1 partnership name, such as Hyams, Hyams and Brief, would not be listed on the return. Second, if a
2 separate entity's information was not supposed to be reported to the government, an FEIN would not be
3 listed on the return. Third, by using "GPGP" for the Secretary of State number, the return reflects that
4 the taxpayer is a general partnership and this box could have been left blank or provided the partners'
5 social security numbers. Fourth, if a partnership was not intended, then line J on the return should not
6 have indicated in box 1 that a general partnership was filing the return; box 6 ("other") could have been
7 marked if the other entity choices did not apply. Fifth, line K indicates there were four partners in this
8 partnership during the tax year, which includes Mr. Hartfelder, who was not a deed owner. Sixth,
9 Schedule K indicates on line 23(b) that all of the partners were general partners. Seventh, Schedule D-1
10 lists "GPGP" (i.e., general partnership) for the partnership's social security number, California
11 corporation number, or Secretary of State number; the individuals' social security numbers could have
12 been used in lieu of "GPGP" if a partnership was not intended. Eighth, each of the four Schedules K-1
13 indicates on line A(1) that the individual is a general partner. Ninth, each of the four Schedules K-1 lists
14 on line D the partner's percentage of profit sharing, loss sharing, and ownership of capital; if the return
15 was only intended for reporting purposes, this line could have been left blank. Lastly, each of the four
16 Schedules K-1 provides on line J an analysis of the partner's capital account, which is not required for
17 bookkeeping purposes and "are only used by partners and a partnership to keep track of what each
18 partner has put into the partnership (i.e.,[.] when a partner contributes or recognizes partnership gain) and
19 what each partner has taken out of the partnership (i.e.,[.] when the partner receives distributions or
20 reports partnership deductions.)" (Resp. Reply Br., pp. 3-5.)

21 Respondent further argues that Mr. Menichiello incorrectly states in his declaration that
22 appellant and the other partners did not realize any tax benefits by filing partnership tax returns.
23 According to respondent, several tax benefits were in fact realized. First, appellant paid taxes based on
24 48.5 percent, rather than 50 percent, of the Electric property income. Second, appellant neither paid
25 taxes nor incurred selling costs when he transferred 1.5 percent of his ownership interest in the Electric
26 property to Mr. Hartfelder. Third, appellant's Schedule K-1 indicates on line J that he has a negative
27 capital account of \$341,007, which "demonstrates that Appellant received excessive tax benefits from
28 the partnership." Lastly, by using the partnership form, appellant was able to obtain in 1982 necessary

1 architectural services when he and the other deed owners could not otherwise afford to pay for an
2 architect because Mr. Hartfelder was given a partnership interest in lieu of money. (Resp. Reply Br., pp.
3 5-6.)

4 Respondent contends that Mr. Menichiello's opinions in paragraphs 4 and 5 of his
5 declaration concerning the states of mind of others should not be given any persuasive value because
6 there is no "explanation as to why Mr. Menichiello would be knowledgeable of events which occurred
7 approximately 20 years before he became the tax preparer for the HHB partnership." (Resp. Reply Br.,
8 p. 6.) Respondent also contends that the declaration is misleading because Mr. Menichiello is not a
9 partner in an accountancy firm, he is not an accountant, and he only began preparing the partnership
10 returns in 2000 for the 1999 tax year. (Resp. Reply Br., pp. 6-9.)

11 In its reply brief, respondent contends that the Electric property should not be excluded
12 from IRC section 761(a)'s definition of a partnership because appellant and the other partners never
13 made the requisite election not to be treated as a partnership. Respondent also contends that appellant
14 and the other partners would not be entitled to such an election because "the Electric Property would not
15 qualify to be anything other than owned by a partnership." Respondent further contends that IRC
16 section 761(a) does not authorize the filing of partnership returns by non-partners to report income and
17 expenses. Lastly, respondent contends that appellant incorrectly cites Treasury Regulation section
18 301.7701-1 for the proposition that joint owners not in a partnership are permitted to file partnership
19 returns for the purpose of reporting income and expenses. (Resp. Reply Br., pp. 9-10.)

20 Applicable Law

21 Proposed Assessment

22 The FTB has the authority to administer and enforce the California income tax laws.
23 (Rev. & Tax. Code, § 19501.) The FTB's initial burden is to show why its assessment is reasonable and
24 rational. (*Todd v. McColgan* (1949) 89 Cal.App.2d 509; *Appeal of Michael E. Myers*, 2001-SBE-001,
25 May 31, 2001.) The FTB's determination of an assessment is presumed correct, and appellant has the
26 burden of proving it wrong. (*Todd v McColgan, supra; Appeal of Michael E. Myers, supra.*)
27 Unsupported assertions are not sufficient to satisfy appellant's burden of proof. (*Appeal of Aaron and*
28 *Eloise Magidow*, 82-SBE-274, Nov. 17, 1982.) In the absence of uncontradicted, credible, competent,

1 and relevant evidence showing error in the FTB’s determinations, they must be upheld. (*Appeal of*
2 *Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.)

3 Like-Kind Exchanges

4 R&TC section 18031 conforms California Personal Income Tax Law to IRC section
5 1031(a), which provides that no gain or loss is recognized when property held for productive use in a
6 trade or business or for investment is exchanged for property of like kind that is held for those same
7 purposes. In order to constitute a tax-deferred exchange, the transaction must be a transfer of property
8 for property, rather than a transfer of property for money. (Treas. Reg. § 1.1031(k)-1(a).) If a taxpayer
9 actually or constructively receives money in the full amount of the consideration for the relinquished
10 property, the transaction will constitute a sale, and not a deferred exchange, even though the taxpayer
11 may ultimately receive like-kind replacement property. (Treas. Reg. § 1.1031(k)-1(a).)

12 For an exchange to qualify for tax-deferred treatment, specific identification and receipt
13 time limitation requirements must be satisfied. After transferring the relinquished property, the taxpayer
14 must identify the replacement property within 45 days and receive the replacement property within 180
15 days. (Int. Rev. Code, § 1031(a)(3).)

16 Partnership for Tax Purposes

17 California conforms to the federal partnership statutory provisions under R&TC section
18 17851, unless otherwise provided. Thus, all references to IRC sections 701 through 761 are
19 incorporated directly into California law. The related federal partnership regulations are similarly
20 incorporated into California law under R&TC section 17024.5, subdivision (d).

21 IRC section 761(a) broadly defines the term partnership for federal tax purposes to
22 include “a syndicate, group, pool, joint venture, or other unincorporated organization through or by
23 means of which any business, financial operation, or venture is carried on, and which is not, within the
24 meaning of this title, a corporation or a trust or estate.” (See also Int.Rev. Code, § 7701(a)(2).)¹⁵

25
26
27 ¹⁵ Staff notes that this definition does not require a written partnership agreement in order for a partnership to exist for tax
28 purposes. (See also *Demirjian v. Commissioner, supra*, 457 F.2d at p. 3, which found the existence of a partnership for tax
purposes, “although no formal partnership agreement was executed.”) In addition, Treasury Regulation section 1.761-1(c)
provides that partnership agreements may be written or oral.

1 Treasury Regulation section 301.7701-1(a)(1) provides:

2 The Internal Revenue Code prescribes the classification of various organizations for federal tax
3 purposes. Whether an organization is an entity separate from its owners for federal tax purposes
4 is a matter of federal tax law and does not depend on whether the organization is recognized as
5 an entity under local law.

6 Treasury Regulation section 301.7701-1(a)(2) provides that certain joint undertakings
7 give rise to entities for federal tax purposes:

8 A joint venture or other contractual arrangement may create a separate entity for federal
9 tax purposes if the participants carry on a trade, business, financial operation or venture and
10 divide the profits therefrom. For example, a separate entity exists for federal tax purposes if co-
11 owners of an apartment building lease space and in addition provide services to the occupants
12 either directly or through an agent. Nevertheless, a joint undertaking merely to share expenses
13 does not create a separate entity for federal tax purposes. For example, if two or more persons
14 jointly construct a ditch merely to drain surface water from their properties, they have not created
15 a separate entity for federal tax purposes. Similarly, mere co-ownership of property that is
16 maintained, kept in repair, and rented or leased does not constitute a separate entity for federal
17 tax purposes. For example, if an individual owner, or tenants in common, of farm property lease
18 it to a farmer for a cash rental or a share of the crops, they do not necessarily create a separate
19 entity for federal tax purposes.

20 Treasury Regulation section 301.7701-2(a) defines business entities for federal tax
21 purposes:

22 For purposes of this section and § 301.7701-3, a *business entity* is any entity recognized
23 for federal tax purposes (including an entity with a single owner that may be disregarded as an
24 entity separate from its owner under § 301.7701-3) that is not properly classified as a trust under
25 § 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code. A
26 business entity with two or more members is classified for federal tax purposes as either a
27 corporation or a partnership. A business entity with only one owner is classified as a corporation
28 or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a
sole proprietorship, branch, or division of the owner. . . .

In *McManus, supra*, 583 F.2d at 447, the Ninth Circuit Court of Appeals held:

Partnership for tax purpose is broader than common law partnership. See 26 U.S. C. §
761(a); Regs. § 1.761-1(1). Here the taxpayers kept their account books on a partnership basis,
opened a partnership bank account, and most importantly filed partnership tax returns. That title
to the land was taken as tenants in common is not determinative since that may be considered
neutral evidence. A taxpayer is estopped from later denying the status he claimed on his tax
returns. (Citations omitted.)

Duty of Consistency

The duty of consistency was discussed by the Ninth Circuit Court of Appeals in *Ashman*
v. Commissioner, supra, as follows:

1
2 While it is true that income taxes are intended to be settled and paid annually each year standing
3 to itself, and that omissions, mistakes and frauds are generally to be rectified as of the year they
4 occurred, this and other courts have recognized that a taxpayer may not, after taking a position in
5 one year to his advantage and after correction for that year is barred, shift to a contrary position
6 touching the same fact or transaction. When such a fact or transaction is projected in its tax
7 consequences into another year there is a duty of consistency on both the taxpayer and the
8 Commissioner with regard to it, whether or not there be present all the technical elements of an
9 estoppel.

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11 In *Ashman, supra*, 231 F.3d at 546, the Ninth Circuit identified the following three
12 elements for meeting the duty of consistency:

- 13 (1) A representation or report by the taxpayer; (2) on which the Commissioner has relied;
14 and (3) an attempt by the taxpayer after the statute of limitations has run to change the
15 previous representation or to recharacterize the situation in such a way as to harm the
16 Commissioner. If this test is met, the Commissioner may act as if the previous representation,
17 on which he relied, continued to be true, even if it is not. The taxpayer is estopped to assert
18 the contrary.

19 STAFF COMMENTS

20 Although the existence of a formal partnership agreement supports the finding of a
21 partnership, a partnership may also exist for tax purposes, even in the absence of a formal partnership
22 agreement. (See footnote 15, *supra*.) Staff notes that corporate and civil law provisions pertaining to
23 the existence of a partnership under state law are not controlling in this appeal. As provided in Treasury
24 Regulation sections 301.7701-1(a)(2) and 301.7701-2(a), a separate entity may be established by a joint
25 venture or other contractual arrangement when the participants conduct a trade, business, financial
26 operation or venture and divide the resulting profits, and a business entity consisting of two or more
27 members is classified for tax purposes as either a corporation or a partnership.

28 Appellant indicates that the IRS did not disallow the like-kind exchange. (App. Supp.
Br., p. 8.) Staff notes that it is not clear that appellant attached a Form 8824 to his 2004 federal
individual return, which would have notified the IRS that he was deferring gains from the sale of the
Electric property under IRC section 1031. Appellant should be prepared to discuss at the oral hearing
whether he reported the like-kind exchange on his 2004 federal individual return, and whether the IRS
has audited the return or examined the purported like-kind exchange.

Appellant should also be prepared to discuss the facts and circumstances surrounding the

1 negative capital account, such as how it developed, and what bearing, if any, it has on the issue of
2 whether the Electric property was owned by the HHB partnership. Specifically, appellant should be
3 prepared to address whether he was the beneficiary of excess tax deductions or distributions, which
4 resulted in this negative capital account balance. Further, appellant should be prepared to address how
5 he was able to incur a negative capital account balance if he, and the other deed owners, were not
6 partners.

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10 Brief_If

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