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7 **BOARD OF EQUALIZATION**

8 **STATE OF CALIFORNIA**

9
10 In the Matter of the Appeal of:) **HEARING SUMMARY**
11) **PERSONAL INCOME TAX APPEAL**
12 **EBEN GOSSAGE**¹) Case No. 546541²
13 _____)

	<u>Years</u>	<u>Proposed Assessments</u>
	2003	\$127,127
	2004	\$149,894

18
19 Representing the Parties:

20 For Appellant: Joyce Rebhun, JD, MBA, PhD
21 For Franchise Tax Board: Daniel V. Biedler, Tax Counsel III
22

23 **QUESTION:** Whether appellant has shown error in respondent's proposed assessment of
24 _____

25 ¹ Appellant resides in San Francisco, California.

26 ² This appeal was scheduled for the October 25, 2011 oral hearing in Culver City. Appellant's representative provided
27 amended returns on September 19, 2011, for the related Appeal of Diane Green (Case ID No. 539627), causing this appeal to
28 be removed from the October oral hearing calendar for additional briefing. This appeal was then scheduled for the July 24,
2012 oral hearing calendar in Culver City. During the scheduling process, this appeal and the Appeal of Diane Green were
scheduled together based on their linked factual history. Based on appellant's request to keep the Appeal of Diane Green in
Sacramento, both appeals were rescheduled to the August 21, 2012 oral hearing calendar in Sacramento.

1 additional tax based on respondent's determination of additional income from
2 Zack's Incorporated Sausalito Marine (Zack's).³

3 HEARING SUMMARY

4 Background

5 Reported IRC section 1031 Transactions

6 Zack's, a subchapter S corporation, was incorporated in California in 1959 as a
7 subchapter C corporation and elected S corporation status in 1999. (Resp. Op. Br., p. 4.) Appellant
8 purchased Zack's in 1989 in a deal that included approximately 14 parcels of real property. Zack's
9 engaged in two reported like kind exchanges, as detailed below.

10 *2003 Transaction*

- 11 • On July 3, 2003, Zack's entered into a "like kind exchange agreement" identifying as
12 the IRC section 1031 replacement property a 50-year leasehold interest in a property
13 on Pacific Avenue in San Francisco.⁴ (Resp. Op. Br., p. 4.)
- 14 • On September 18, 2003, Zack's sold the "Dunphy Park" property to the City of
15 Sausalito for \$1,220,400. (*Id.* at exhibit C, p. 2.)
- 16 • On November 26, 2003, Zack's sold the "Waterfront" property to the City of
17 Sausalito for \$500,000.⁵ (*Ibid.*)

18 Sometime thereafter, Zack's acquired a 99-year leasehold interest in the property on
19 Pacific Avenue, the exact date of which is unclear,⁶ with Zack's set to take possession
20

21 ³ As explained herein, the income that led to the proposed assessment in this appeal was the result of an audit conducted by
22 respondent focusing on gain resulting from property sale transactions for which Zack's was denied tax deferral under the like
23 kind exchange rules provided for in Internal Revenue Code (IRC) section 1031 (incorporated by Revenue and Taxation Code
section 24941).

24 ⁴ The exact address of the property on Pacific Avenue has been redacted. All references to property on Pacific Avenue refer
to the same address.

25 ⁵ Zack's sold these two properties to the City of Sausalito in 2003 for a total of \$1,720,400. (Resp. Op. Br., exhibit C, p. 2.)
26 Respondent in a footnote in its brief states three properties were sold in 2003, including the "Bridgeway" property with the
27 two listed above. (Resp. Op. Br., p. 4, fn. 9.) As discussed below, it appears the Bridgeway property was actually sold in
2004. The parties should be prepared to clarify the properties sold in 2003 and 2004, should it be raised at the hearing.

28 ⁶ Respondent provides a full copy of the lease agreement with no dates or signatures, a second signature page with signatures
and the dates redacted prior to respondent receiving it. Respondent provides a third copy of the signature page, apparently
received later, with different signatures and the date of March 1, 2004. (Resp. Op. Br., exhibits D, pp. 32-33, & E.)

1 as of April 1, 2004. (Resp. Op. Br., p. 4 & exhibits D & E.) The lease was for 400 of
2 the approximately 7,000 square feet in the building at the Pacific Avenue address,
3 with Zack's owning a 30 percent undivided interest in the lease and appellant owning
4 the remaining 70 percent interest. (*Id.* at p. 5.)

5 Respondent indicates Zack's 2003 depreciation schedules reported deductions of \$2,565
6 and \$6,837 for 2002 and 2003, respectively, for property located at the same Pacific Avenue address,
7 based on an acquisition date of August 27, 2002, and a basis in the property of \$188,046. (Resp. Op.
8 Br., p. 5.) Based on this reporting, it is unclear whether Zack's had a preexisting lease, and the claimed
9 replacement property may have actually been a renewal of the lease on April 1, 2004. On its 2003
10 return, Zack's reported a like kind exchange of the two properties sold in exchange for a 30 percent
11 interest in a 99 year leasehold on Pacific Avenue.⁷ (*Ibid.*) On its 2003 return, Zack's stated appellant
12 was the sole shareholder. (*Id.* at p. 4.)

13 *2004 Transaction*

- 14 • On June 5, 2004, Zack's entered into a "like kind exchange agreement" identifying
15 the "Bridgeway" commercial property as the property to be sold, and identifying as
16 the IRC section 1031 replacement property a 30 year leasehold at the Pacific Avenue
17 property. (Resp. Op. Br., p. 5.)
- 18 • On June 9, 2004, Zack's sold the Bridgeway property for \$1,406,000.
- 19 • On December 14, 2004, Zack's entered into a "like kind exchange agreement"
20 identifying property on Locust Street as the property to be sold, and on January 23,
21 2005, identified as the IRC section 1031 replacement property a \$1,030,000 fractional
22 interest in the leasehold at the Pacific Avenue property.
- 23 • On December 15, 2004, Zack's sold the Locust Street property for \$915,000. (*Ibid.*)

26 ⁷ Respondent provides a calculation of the present value of the leasehold created by Zack's. (Resp. Op. Br., p. 5, Ins. 6-8.)
27 Respondent disputes these amounts and presents alternative calculations to contend that the value of the portion of the
28 replacement property attributable to Zack's was substantially lower than Zack's calculated. (*Id.* at exhibit B.) The amount of
deferral of recognition of gain for purposes of IRC 1031 is limited to the value of the replacement property. (See *Id.* at p. 2,
fn. 11.)

1 On its 2004 return, Zack's reported a like kind exchange of the properties sold for
2 unspecified portions of appellant's 70 percent interest in the 99-year leasehold at Pacific Avenue that
3 was acquired during the year. (*Ibid.*) On the return, Zack's reported appellant as a 76.571131 percent
4 owner, and the other shareholder, Diane Green, as a 23.428869 percent owner.⁸ (Resp. Op. Br., p. 4.)

5 FTB Audit

6 Respondent audited Zack's 2003 and 2004 tax years, and found that Zack's did not meet
7 the requirements for tax deferral on the claimed IRC section 1031 transactions. Because Zack's is an S
8 corporation, the capital gains on the sales of property are allocated to its shareholders. (Resp. Op. Br., p.
9 6; Rev. & Tax. Code § 23800 [incorporating Int.Rev. Code § 1366(a)(1)(A)].) The tax assessments
10 were issued on September 9, 2009. Zack's agreed to the findings at audit. (*Id.* at exhibit A.) The
11 assessments became final on December 9, 2009.

12 Respondent's audit determined that Zack's did not meet the requirements for IRC section
13 1031 treatment because the exchange of the replacement property (the leasehold interest) was not
14 completed within 180 days after the transfer of the first exchanged property (September 18, 2003).
15 (Resp. Op. Br., exhibit C, p. 2.) The audit findings state that the execution date of the lease document
16 could not be validated, since the copy provided with original signatures had the dates redacted and the
17 subsequent copy provided has dates of March 1, 2004, listed but had signatures that did not match the
18 original document's signatures, and was therefore not conclusive. In accordance with the 180 day rule,
19 Zack's needed to receive the replacement property by March 15, 2004 but the terms of the lease contract
20 state Zack's took possession of the property on April 1, 2004, beyond the 180 day limit. Therefore,
21 according to the audit findings, even if the lease was signed March 1, 2004, Zack's did not receive the
22 property until it was legally able to occupy the premises, which was April 1, 2004. (*Ibid.*) To compute
23 the gain, the auditor took the total sale amount for both properties sold in 2003 of \$1,720,400, reduced it
24 by the basis of \$59,284, and found a gain of \$1,661,116. The auditor then subtracted \$96,963 from the
25 gain for the amount already reported and \$1,629 for selling expenses and reached a final reportable gain
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27 _____
28 ⁸ The status of Diane Green as a shareholder is contested in a separate appeal (No. 539627). For purposes of this appeal, appellant will be referred to as the majority shareholder for 2004.

1 of \$1,562,524. (*Id.* at exhibit C, p. 3.) The auditor used a disallowed gain deferral amount of
2 \$1,564,153⁹ to find a corporate tax of \$22,763.¹⁰ (*Id.* at exhibit C, p. 7.)

3 Respondent's audit also determined that Zack's did not receive a replacement property
4 for the Bridgeway property within 180 days of its 2004 sale. (Resp. Op. Br., exhibit C, p. 4.) Zack's
5 asserted on its 2004 tax return that the replacement property was a fractional interest in the Pacific
6 Avenue leasehold acquired by appellant in the 2003 acquisition.¹¹ However, the audit found that there
7 was no evidence validating the transfer, and on the Exchange Information Worksheet provided by
8 Zack's, the seller is listed as Grant Richards. Since the transfer of replacement property could not be
9 verified, the gain deferral was disallowed. The gain of \$1,406,000 was reduced by \$25,890 in basis to
10 reach a reportable gain of \$1,380,110.¹² (*Id.* at exhibit C, pp. 4-5.) The auditor also disallowed the
11 deferral of tax on the gain from the sale of the Locust Street property because the auditor found that
12 Zack's did not verify that appellant transferred a portion of his Pacific Avenue lease to Zack's, despite a
13 letter from appellant asserting he transferred a \$1,300,000 interest. Respondent's audit findings state
14 that there is no supporting evidence for this transfer (e.g., rent payments, proof of consideration, etc.),
15 and appellant's interest in the lease was calculated to be \$394,475 and therefore insufficient to meet the
16 claimed \$1,300,000 transfer. (*Id.* at exhibit C, p. 5.) The auditor deducted the following amounts from
17 the \$915,000 sale price: \$22,098 for basis, \$48,224 for cash received, and \$46,877 for allowable selling
18 expenses, which resulted in a reportable gain of \$797,801.¹³ (*Id.* at exhibit C, p. 6.) The total
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21 ⁹ The audit paperwork does not explain the slight discrepancy between the reportable gain amount and the disallowed gain
22 deferral amount.

23 ¹⁰ The audit took a net income loss of \$44,986, added the disallowed gain amount, and subtracted selling expenses of \$1,629
24 to reach a revised taxable income of \$1,517,538. That amount was multiplied by the 1.5 percent corporate tax to reach the
25 final additional tax of \$14,313.00. (Resp. Op. Br., exhibit C, p. 7.) Built in gains tax was also applied, as described below.

26 ¹¹ As stated above, when Zack's entered into the leasehold agreement on the Pacific Avenue property, it took a 30 percent
27 interest in the lease while appellant acquired a 70 percent interest. Here, Zack's allegedly acquired some of appellant's 70
28 percent interest.

¹² Respondent's audit determined Zack's did not verify the claimed \$223,567 of selling expenses, and disallowed this
amount. (Resp. Op. Br., exhibit C, p. 4.)

¹³ Respondent disallowed the \$105,881 claimed selling expenses, and instead allowed \$46,877 based on figures in the final
settlement statement provided on the sale of the land. (Resp. Op. Br., exhibit C, pp. 5-6.)

1 disallowed \$2,224,788 in gain deferral led to a corporate tax of \$14,313.¹⁴ (*Id.* at exhibit C, p. 7.)

2 In addition to the recognition of income from the disallowed 1031 transactions,
3 respondent's auditor determined Zack's was subject to the built in gains tax. (Resp. Op. Br., exhibit C,
4 pp. 3-4 & 6-7.) Respondent's auditor found that Zack's acquired the properties sold in 2003 during
5 April of 1972, when Zack's was a C corporation. (Resp. Op. Br., 6.) Pursuant to IRC section 1374,
6 Zack's was required to recognize the built in gain at the time of the S corporation election in 1999
7 (computed as the fair market value of the property at the time Zack's became an S corporation over the
8 adjusted basis in the properties), and was required to pay tax on that built in gain. Respondent found the
9 properties sold during 2003 had a fair market value of \$314,329 on January 1, 1999, when Zack's made
10 its S corporation election, and Zack's had an adjusted basis in the property of \$59,284. Because the
11 properties were sold within ten years (also known as the recognition period), built in gains were
12 triggered. The gain is calculated as the fair market value at the time of conversion (\$314,329) over the
13 adjusted basis (\$59,284) and was found to be \$255,045. That gain was multiplied by the 8.84 percent
14 tax rate, resulting in a built in gains tax of \$22,546.00. (*Ibid.*)

15 The auditor found that the properties sold by Zack's in 2004 were also acquired in April
16 of 1972. (Resp. Op. Br., p. 6.) The properties had a fair market value of \$117,166 and an adjusted basis
17 of \$22,098 at the time of S corporation election. These assets were also sold within the recognition
18 period, and triggered a built in gains tax. For 2004, the audit applied Zack's net operating loss from its
19 C corporation period (\$45,871) to reduce the gain recognized of \$95,068 down to \$49,197, before
20 calculating the built in gains tax amount of \$4,349. Respondent reports that Zack's did not contest the
21 audit findings, and the assessments became final on December 9, 2009. Since appellant was reported as
22 a 76.571131 percent owner of Zack's, he was only allocated that percentage of the tax amount, and
23 respondent issued Notices of Proposed Assessment (NPAs) for 2003 and 2004.¹⁵ (*Id.* at p. 7)

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26 ¹⁴ The audit took a net income loss of \$139,543, added the disallowed gain amount, and subtracted selling expenses of
27 \$46,877 to reach a revised taxable income of \$2,038,368. That amount was reduced by the net operating loss carryover of
28 \$1,084,170 to reach an income amount of \$954,198. That amount was multiplied by the 1.5 percent corporate tax to reach
the final additional tax of \$14,313. (Resp. Op. Br., exhibit C, p. 7.) Built in gains tax was also applied, as described below.

¹⁵ The other 23.428869 shareholder interest was reported to Diane Green.

1 Respondent provides a letter from appellant's CPA, who represented appellant and Zack's at audit,
2 stating that appellant agreed with the audit results presented in the NPAs, and was asking for a
3 settlement conference due to his inability to pay. (*Id.* at exhibit A.) Respondent states it determined
4 appellant had not provided sufficient information upon which to base a reduced payment or alternate
5 arrangement and issued Notices of Actions affirming the NPAs. (*Ibid.*) This appeal followed.

6 Purported Amended Returns

7 On September 19, 2011, Ms. Green and appellant's representative, Ms. Rebhun,
8 delivered to respondent purported amended returns for Diane Green's federal and state personal tax
9 liabilities, and an amended income tax return for Zack's, including a Schedule K-1 reflecting appellant
10 as a 100 percent shareholder in 2004. (Resp. Add'l Exhibits.) No amended return was provided for
11 appellant. Due to the late nature of this submission, this appeal was pulled from the October 25, 2011
12 oral hearing calendar to allow the parties to discuss the purported amended returns.

13 These documents were prepared and signed by appellant's representative on appeal, Ms.
14 Rebhun, dated September 18, 2011, on behalf of both appellant (as president of Zack's) and Ms. Green.
15 The returns purport to remove Ms. Green as a shareholder of Zack's in 2004. Ms. Green's amended
16 state return provides in its explanation section that she was issued a Schedule K-1 without her
17 permission or knowledge, and is removing any tax benefit from her return because the Schedule K-1
18 was issued in error. The federal amended return for Ms. Green similarly claims her accountant
19 erroneously attributed to her ownership in Zack's, that she had no interest whatsoever in Zack's, and
20 states the president of Zack's (i.e., appellant) has filed an amended return for the 2004 tax year to claim
21 100 percent ownership of Zack's.¹⁶

22 Contentions

23 Appellant

24 Appellant contends the original auditor abused her discretion in finding Zack's
25 transactions did not qualify as IRC section 1031 like kind exchanges, and made errors in the subsequent
26

27 ¹⁶ No copy of any amended personal income tax return by appellant has been received on appeal, and there is no indication
28 that such an amended return has been created or filed with either the Internal Revenue Service (IRS) or respondent other than
statements from appellant's representative, including the notes on Ms. Green's federal amended return.

1 computation of state taxes owed based upon that determination. (Appeal Letter, p. 2.) Appellant
2 indicated in its appeal letter that he would request “audit reconsideration” from respondent for Zack’s
3 2003 and 2004 corporate tax years.¹⁷ (*Id.* at pp. 2-3.) Appellant asserts respondent gives no credible
4 explanation of how the additional taxes were calculated, other than a reference to the related audit of
5 Zack’s. (*Id.* at p. 3.)

6 Appellant provides a synopsis of the facts in his opening brief, indicating the acquisition
7 of the replacement property by Zack’s for the 2003 tax year went into effect after the 180 day statutory
8 period. (App. Op. Br., p. 1.) However, appellant disputes respondent’s position that the acquisition was
9 not effective within 180 days after the first relinquished property was sold. Appellant contends the gains
10 from the properties relinquished in 2004 were “deferred” into the same 99 year leasehold as the 2003
11 gains. Appellant asserts he will present “substantive evidence to support the acquisition of the
12 leaseholds for the 2004 exchanges.”¹⁸ (*Ibid.*) Appellant contends the gain from the disallowed
13 transactions is not taxable.¹⁹ (*Id.* at p. 2.)

14 After receiving a copy of Ms. Green and Zack’s purported amended returns, this matter
15 was postponed from the October 25, 2011 oral hearing calendar for further development. Appeals
16 Division staff requested additional briefing from the parties, specifically asking appellant to provide
17 briefing on the new returns and how they support or otherwise affect his position on appeal. Appellant’s
18 representative replied stating the amended returns were submitted with appellant’s permission to reflect
19 his 100 percent ownership in Zack’s in 2004, and stating that Ms. Rebhun had “Power of Attorney to
20 sign and file any and all tax returns to correct this unintended and unfortunate tax situation.” (App.
21 Add’l Br.; App. Add’l Reply Br.)

22 Respondent

23 Respondent notes that appellant is the director, officer, and shareholder of Zack’s, and
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25 ¹⁷ It does not appear from the record that any subsequent audit or request for audit has been issued for these tax years.

26 ¹⁸ Any additional documents and evidence should be provided at least 14 days prior to the date of the oral hearing. Exhibits
27 should be submitted to: Claudia Madrigal, Board of Equalization, Board Proceedings Division, P.O. Box 942879 MIC:80,
28 Sacramento, CA 94279-0080.

¹⁹ Based on this contention, appellant asserts the other various changes to his 2003 and 2004 tax accounts included in the
notices of action resulting from his share of Zack’s income are also incorrect. (App. Op. Br., p. 2.)

1 did not protest the audit findings for Zack's 2003 and 2004 years. Respondent also attaches a letter from
2 appellant's representative stating that appellant agrees with the findings of the audit and requests a
3 settlement conference. (Resp. Op. Br., p. 16 & exhibit A.) Respondent contends appellant's appeal of
4 the audit findings after explicitly conceding them constitutes a breach of the duty of consistency. In this
5 regard, respondent argues that appellant and Zack's have a privity of interest through appellant's
6 ownership interest in Zack's. In support of that proposition, appellant cites *Shanafelt v. U.S.*, 97-2 U.S.
7 Tax Cas. (CCH) P50,098, in which the tax court held that the taxpayer, who was the president and sole
8 shareholder of a taxpayer corporation, was properly held to a duty of consistency with respect to the
9 income tax reporting position of the corporation. (*Id.* at p. 17.) Thus, respondent asserts that appellant
10 acted for Zack's and himself when conceding the correctness of the audit, and he should be barred by
11 the duty of consistency from asserting that transactions engaged in by Zack's have different tax
12 consequences for him than for Zack's. (*Id.* at p. 19.)

13 Respondent contends the property transactions at issue must be treated as sales that did
14 not qualify as tax-deferred exchanges because Zack's did not receive replacement property within 180
15 days. (Resp. Op. Br., p. 7.) Respondent asserts appellant's only evidence provided to establish that the
16 transaction qualified as like kind exchanges under IRC section 1031, which includes the formation of the
17 lease contract, the transfer of replacement property, and use of the proceeds from the sale of relinquished
18 properties, are "sparse offerings of dubious nature." (*Id.* at p. 10.) Respondent states it has made
19 multiple attempts to acquire explanations and documentation from appellant to help substantiate the like
20 kind exchanges, but has not received sufficient formal documents and any documents presented at this
21 point in the proceedings would be "questionable and improbable," lacking in credibility. (*Ibid.*)

22 Respondent reaffirms the findings of the audit upon Zack's 2003 and 2004 tax years,
23 contending there is no evidence of a valid transfer of a leasehold interest within 180 days of the earliest
24 date of relinquishment of property. (Resp. Op. Br., pp. 11-12.) Respondent refers to the California Civil
25 Code to define a leasehold as an estate in real property which can be transferred only by operation of
26 law or by written instrument such as a written contract, signed by the transferor or an agent, and that a
27 lease agreement as an enforceable contract must be signed and delivered in order to be valid, and the
28 interest intended to be conveyed is not vested until such time as it is signed and delivered. (*Ibid.*; Civil

1 Code sections 1091, 783, 1626, 1054 & 1055.) Respondent asserts appellant has not verified when the
2 lease agreement for replacement property for Zack's 2003 attempted like kind exchange was signed, and
3 therefore it cannot be determined that the lease agreement was signed prior to the March 16, 2004
4 deadline (180 days after the first property was relinquished). (Resp. Op. Br., pp. 13-14.) Therefore,
5 respondent contends the date Zack's took possession of the lease, April 1, 2004, is the most reliable date
6 for determining when Zack's received an estate in real property in exchange for the relinquished
7 property, and therefore Zack's failed the 180 day requirement for like kind exchanges for the 2003 tax
8 year.²⁰ (*Id.* at p. 14.)

9 Respondent contends appellant likewise fails to show Zack's obtained replacement
10 property for the properties relinquished in 2004 within the 180 day window. Respondent indicates that
11 Zack's would have had to receive replacement property by December 6, 2004, in order to meet the 180
12 day requirement for the 2004 tax year. (Resp. Op. Br., p. 14.) Respondent asserts appellant has not
13 provided any evidence to substantiate the transfer of the leasehold interest from appellant to Zack's
14 other than a statement from appellant. (*Id.* at p. 15.) Respondent contends no evidence of consideration
15 for the transfer has been provided, and there is no evidence that Zack's paid a bigger portion of the rent
16 under the lease agreement. In addition, respondent asserts appellant used a faulty method to value the
17 99 year lease, and in reality the value of appellant's share of the lease was substantially less than the
18 amount claimed to have been transferred to Zack's as replacement property.

19 Respondent provided additional briefing upon request to discuss the purported amended
20 returns prepared and submitted by Ms. Rebhun, representative on appeals for both appellant and Ms.
21 Green. Respondent states it will not accept the submissions as amended returns. Respondent
22 emphasizes that these returns were filed approximately two and a half years after the expiration of the
23 statute of limitations on assessment of additional tax, more than six years after the original due date of
24 the returns, and well after Zack's agreed to the assessment of additional tax related to the income at
25 issue in this appeal. (Resp. Add'l Br., p. 2.) Respondent asserts appellant's response to the request for
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28 ²⁰ Respondent cites to an unpublished 9th Circuit Court of Appeals case to support its contentions that the deadlines imposed
under IRC section 1031(a)(3)(B) are to be construed as strict. (Resp. Op. Br., p. 9.) Unpublished decisions issued before
January 1, 2007, are generally not admissible as precedent; however, the same general concept is provided for in *United*
States v. Locke (1985) 471 U.S. 84, at pages 100-101, in regard to filing deadlines in general. (See 9th Cir. R. 36-3(a).)

1 briefing on the amended returns is extremely limited and lacks integrity and veracity. (*Id.* at p. 3.)
2 Specifically, respondent states there is no indication that Ms. Rebhun has authority to file such
3 documentation on behalf of appellant, Ms. Green, or Zack's, and the assertions made in the filings
4 expressly violate appellant's duty to consistently report items of income. (*Ibid.* [citing *Estate of Hilda*
5 *Ashman v. Comm'r of Internal Revenue* (9th Cir. 2000) 231 F.3d 541].) Respondent alleges appellant
6 appears to be seeking to relieve his associate, Ms. Green, from her liability of additional tax based on
7 her proportionate share of the gains from Zack's while simultaneously avoiding that same liability
8 himself. Respondent contends that appellant has not personally asserted in this appeal that he was the
9 100 percent shareholder of Zack's in 2004 and therefore responsible for 100 percent of the gains, but, as
10 president of Zack's and through the amended returns asserts in Ms. Green's appeal that she was not a
11 shareholder in 2004. Respondent contends appellant is attempting to argue two different positions, one
12 in each appeal, contrary to the duty of consistency.

13 Applicable Law

14 Burden of Proof

15 It is well settled that a presumption of correctness attends respondent's determinations as
16 to issues of fact and that an appellant has the burden of proving such determinations erroneous. This
17 presumption is, however, a rebuttable one and will support a finding only in the absence of sufficient
18 evidence to the contrary. To overcome the presumed correctness of respondent's findings as to issues of
19 fact, a taxpayer must introduce credible evidence to support his assertions. When the taxpayer fails to
20 support his assertions with such evidence, respondent's determinations must be upheld. (*Appeal of*
21 *Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Jun. 29, 1980.)

22 IRC section 1031

23 California law conforms to IRC section 1031 at R&TC sections 18031 and 24941. For a
24 transfer of property to qualify for non-recognition of gain treatment under IRC section 1031, three
25 general requirements must be satisfied: (1) the transaction must be an exchange; (2) the exchange must
26 involve like kind properties; and (3) both the property transferred (the *relinquished property*) and the
27 property received (the *replacement property*) must be held for a qualified purpose. (Int.Rev. Code,
28 § 1031(a)(1).) Property will not be treated as like kind if the property is received later than 180 days

1 after the date the relinquished property was transferred. (*Id.* at subsection (a)(3)(B).) The United States
2 Tax Court has held that even when forces outside the taxpayer's control delay the acquisition of the
3 replacement property, if the taxpayer receives the intended replacement property beyond the 180 day
4 period, the exchange does not qualify for like kind exchange treatment and the gain on the sale must be
5 recognized as taxable income. (*Knight v. Commissioner* (1998) 75 T.C.M. (CCH) 1992.) In addition,
6 the plain language of the statute does not allow for good faith attempts to validate what is otherwise an
7 exchange transaction that exceeds the 180 day period. (*Ibid.*)

8 Duty of Consistency

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

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

19 In *Ashman, supra*, 231 F.3d at 546, the Ninth Circuit articulated the following three
20 elements for finding that a taxpayer breached the duty of consistency:

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

27 STAFF COMMENTS

28 Appellant has not provided evidence to support the assertions that the like kind
exchanges were valid under IRC section 1031. In order to prevail, appellant will need to provide
accurate and credible evidence establishing compliance with IRC section 1031, such as the dates the
replacement properties were acquired and a reliable determination of their values. If appellant has
evidence to substantiate compliance with IRC section 1031 requirements, it should be provided at least

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1 14 days prior to the date of the oral hearing.²¹

2 If the Board determines that appellant has not carried his burden of showing that the
3 exchanges satisfied the requirements of IRC section 1031, there is no need for it to rule on whether the
4 duty of consistency applies. Respondent should be prepared to explain how the three elements of the
5 duty of consistency, as set forth in *Ashman, supra*, are satisfied here.

6 Staff notes that there is also the pending Appeal of Diane Green (Case ID No. 539627)
7 for the 2004 tax year. In that appeal, respondent asserts that Ms. Green was also a shareholder in Zack's
8 and proposed an assessment of income from Zack's for 2004. Ms. Green contends she was not a
9 shareholder of Zack's during the 2004 tax year. Ms. Green's representative, who is also appellant's
10 representative, has submitted purported amended returns, as discussed in the Background section. These
11 returns, one of which is signed on appellant's behalf by his representative, claim appellant was the sole
12 shareholder in 2004, and therefore would be liable for tax on 100 percent of the gain in 2004.²²
13 Appellant is asked to state whether he concurs with the assertion made in that appeal that he was a 100
14 percent shareholder of Zack's in 2004. If appellant agrees with that position, he should be prepared to
15 state why his personal return and Zack's original corporate return for the 2004 tax year show Ms. Green
16 as a shareholder, and explain why no attempt to correct this reporting has been made earlier, and why he
17 has not submitted an amended personal income tax for 2004 reflecting this. Given the circumstances,
18 the Board may wish to hear arguments in both appeals prior to making a motion in favor of either party
19 in this appeal.

20 ///

21 Gossage_jj
22 _____

23 ²¹ Exhibits should be submitted to: Claudia Madrigal, Board of Equalization, Board Proceedings Division, P.O. Box 942879
24 MIC:80, Sacramento, CA 94279-0080.

25 ²² However, as contended by respondent in its additional briefing, the statute of limitations would likely bar respondent from
26 being able to propose an assessment on the additional income beyond that included in this appeal. Therefore, that additional
27 amount would be taxable yet the tax on that amount would be uncollectable. In other words, respondent only assessed
28 additional tax on appellant as an approximately 77 percent owner of Zack's for 2004, as reported on his returns and Zack's.
It appears that if appellant successfully now claims to be a 100 percent owner, relieving Ms. Green of her approximately 23
percent of the liability, after the statute of limitations for assessing additional tax has passed, respondent would not be able to
assess tax on the approximately 23 percent portion. Ms. Green would be alleviated of her liability, and appellant would not
incur any additional assessable liability. (Resp. Add'l Exhibits, p. 3.)