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10 **BOARD OF EQUALIZATION**

11 **STATE OF CALIFORNIA**

12 In the Matter of the Appeal of:

) **HEARING SUMMARY<sup>1</sup>**

) **PERSONAL INCOME TAX APPEAL**

13 **ANSER HASSAN**

) Case No. 536983

<u>Year</u>	<u>Proposed</u> <u>Additional Tax<sup>2</sup></u>	<u>Proposed</u> <u>Penalty</u>
2003	\$26,680	\$6,670

14 Representing the Parties:

15 For Appellant: Syed B. Hassan

16 For Franchise Tax Board: Jenna Mayfield, Tax Counsel

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 21 **QUESTIONS:** (1) Whether appellant has demonstrated error in respondent's determination of a  
 22 capital gain arising from the sale of a personal residence.

23 (2) Whether appellant has shown that he is entitled to an increase in deductions

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 26 <sup>1</sup> This appeal was postponed from the June 26, 2012 hearing calendar and rescheduled to the September 12, 2012 hearing  
 27 calendar due to appellant's representative's scheduling conflict. At appellant's request, this appeal was postponed from the  
 28 September 12, 2012 hearing calendar and rescheduled to the November 13, 2012 hearing calendar due to a family emergency  
 that required appellant to be out of the country.

<sup>2</sup> As discussed below, respondent has stated on appeal that it will reduce the amount of tax from \$26,680 to \$26,218 and the  
 amount of the late filing penalty from \$6,670 to \$6,555.

1 related to the personal residence.

2 (3) Whether appellant is entitled to use head of the household (HOH) filing status for  
3 2003.

4 HEARING SUMMARY

5 Background

6 This appeal concerns the tax consequences of the multiple conveyances of a residential  
7 property located on Saddleback Drive in Danville, California. Appellant's parents, Syed B. Hassan and  
8 Azra B. Hassan, and appellant's uncle and aunt, Syed A. Hassan and Carolyn Hassan, purchased the  
9 property for an undisclosed price on September 17, 1980. The two couples were reportedly equal  
10 owners of the property and each couple reportedly paid 50 percent of a total down payment of \$150,000.  
11 Appellant's parents reportedly lived at the property and paid the mortgage payments, property taxes and  
12 the capital improvement costs. On May 27, 1983, appellant's uncle and aunt transferred their interest in  
13 the property to appellant's parents by a quit claim deed in consideration for a reported payment of  
14 \$75,000. On August 27, 1998, appellant's father transferred his interest in the property to appellant's  
15 mother by an interfamily transfer deed. On September 8, 2000, appellant's mother transferred her  
16 interest in the property to appellant and herself as joint tenants by a gift deed. On February 24, 2003,  
17 appellant and his mother transferred the property to a trust by a grant deed. On March 11, 2003, the  
18 property was transferred from the trust to appellant alone by a grant deed. Appellant sold the property to  
19 a third party by a grant deed, on November 25, 2003 (i.e., the recording date of the transaction), for a  
20 sales price of \$1,200,000. After escrow was completed, the title company issued a check payable to  
21 appellant in the net amount of \$83,999.41. (Appeal Letter, p. 1; Resp. Opening Brief, pp. 1-2, exhibits  
22 A-J.)

23 Appellant did not file a timely California income tax return for 2003. Respondent  
24 received information which indicated that appellant earned wage income sufficient to have a California  
25 filing requirement for 2003. On February 7, 2005, respondent sent appellant a request for a tax return,  
26 which provides that appellant should file or explain why he was not required to file a 2003 return. After  
27 appellant did not respond to the request, respondent issued to appellant a Notice of Proposed Assessment  
28 (NPA), dated April 25, 2005, which proposed a tax liability of \$156, and imposed a late filing penalty of

1 \$100 plus interest. Appellant failed to protest the NPA and it became final. Respondent issued  
2 collection notices and an Earnings Withholding Order for Taxes. Respondent subsequently issued an  
3 Order to Withhold Personal Income Tax to Wells Fargo Bank. Wells Fargo Bank debited appellant's  
4 account in compliance with the order, which satisfied appellant's 2003 account balance due. (Resp.  
5 Opening Brief, pp. 2-3, exhibits K-Q.)

6 On April 13, 2007, appellant filed a 2003 California return reporting taxable income of  
7 \$17,974 consisting only of his wages.<sup>3</sup> On the signature line of appellant's 2003 return, there was the  
8 following handwritten notation: "First return was lost per Franchise Tax Board. This is 2<sup>nd</sup> filing."  
9 (Resp. Opening Brief, p. 3, fn. 17, exhibit R.)

10 Respondent subsequently audited appellant's 2003 return and found that appellant failed  
11 to report any capital gain from the sale of the property. After subtracting settlement fees of \$46,342  
12 from the sales price of \$1,200,000, the auditor calculated net sale proceeds of \$1,153,658. The auditor  
13 determined that appellant had the same cost basis of \$508,000 that his mother had at the time she  
14 conveyed the property to him. During the audit, appellant submitted receipts totaling \$41,279 for the  
15 cost of capital improvements made to the property. The auditor allowed the claimed improvement costs  
16 in full, resulting in an adjusted basis in the property of \$549,279 (\$508,000 + \$41,279). By subtracting  
17 the adjusted basis of \$549,279 from the net sale proceeds of \$1,153,657, the auditor calculated a  
18 \$604,378 gain on the sale. The auditor applied an Internal Revenue Code (IRC) section 121 tax  
19 exclusion of \$250,000, resulting in a taxable gain of \$354,378 (\$604,378 - \$250,000). According to  
20 respondent, the auditor allowed a deduction for paid property taxes but applied the higher amount of the

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26 <sup>3</sup> Appellant filed a Form 540 2EZ California Resident Income Tax Return for 2003, reporting wage income of \$21,044.25.  
27 This return does not include a line which reflects a taxpayer's California taxable income for the year, but merely a subtotal  
28 which cumulates the taxpayer's total income from various sources. The standard deduction (and the personal exemption) for  
taxpayers who file this return is built into the Form 540 2EZ tax tables. Appellant's total income for 2003 of \$21,044  
(rounded), less the \$3,070 standard deduction for single taxpayers for that year, results in a taxable income calculated of  
\$17,974.

1 standard deduction (\$3,070).<sup>4</sup> (Appeal Letter, p. 2, Attachment; Resp. Opening Brief, pp. 3-4, exhibit S;  
2 App. Reply Br., p. 2.)

3 Based on the audit, respondent issued a second NPA, dated September 11, 2009, which  
4 increased appellant's California taxable income by \$354,378 from the reported amount of \$17,974 to  
5 \$372,352 to account for the unreported taxable gain from the sale of the property. The second NPA  
6 proposes additional tax of \$32,334.00 and imposes a late filing penalty of \$8,022.50 plus interest.  
7 (Resp. Opening Brief, p. 3, exhibit S.)

8 Appellant protested the second NPA. The protest officer sustained the auditor's  
9 determination as to the taxable gain amount of \$354,378, but adjusted the allowed amount of deductions.  
10 Because the protest officer determined that the escrow statement showed that sales proceeds were used  
11 to pay \$75,094 of mortgage interest and \$3,574 of property taxes, the protest officer allowed itemized  
12 deductions of \$78,668 for paid mortgage interest and paid property taxes. The protest officer reduced  
13 the itemized deductions from \$78,668 to \$64,746 due to the itemized deduction phase-out under  
14 Revenue & Taxation Code (R&TC) section 17077. Based on this adjustment, the protest officer  
15 decreased appellant's taxable income from \$372,352 to \$310,676. The \$310,676 revised taxable income  
16 consists of the reported wage income of \$21,044 and the unreported taxable gain of \$354,378 less  
17 itemized deductions of \$64,746. Consequently, appellant's additional tax was decreased from  
18 \$32,334.00 to \$26,680.00 and his late filing penalty was reduced from \$8,022.50 to \$6,670.00.  
19 Respondent issued a Notice of Action (NOA), dated June 7, 2010, which reflects these revisions to the  
20 second NPA. Appellant filed this timely appeal. (Resp. Opening Brief, p. 4, exhibit T.)

### 21 Appellant's Contentions

#### 22 Deed Transfers

23 Appellant argues that he neither purchased the property nor acquired it as a gift.  
24 Appellant contends that his father wanted to refinance the mortgage to obtain money to use for his  
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26 <sup>4</sup> It appears that the NOA allowed \$3,574 of property taxes plus other itemized deductions (as these deductions exceeded the  
27 standard deduction). The NOA adds back the \$3,070 standard deduction and in its place permits total itemized deductions of  
28 \$64,746. Appellant states that the auditor only allowed \$3,574 of property tax, although the actual amount of paid property  
tax in 2003 was \$6,962. Attached to the appeal letter is a copy of a 2003 Form 1098, Mortgage Interest Statement, from  
Washington Mutual Bank that lists \$6,962.04 of paid property taxes. (Appeal Letter, p. 2, Attachment.)

1 business or, alternatively, to pay for his mother's medical expenses after she was diagnosed with cancer  
2 in 2003. Appellant asserts that, to obtain refinancing, the title to the property was transferred to his  
3 name because he had good credit. He also asserts that the new loan was not completed because he did  
4 not meet the required conditions. Appellant further states that he and his parents were not diligent about  
5 reconveying the property to his mother. He contends that, although his father tried to exploit him for  
6 financial gain, his mother wanted to reconvey the property to herself to protect him from financial  
7 problems that might arise. According to appellant, his mother was unable to sign the necessary  
8 documents at the title company to reconvey the property to herself because she became too ill from the  
9 cancer and her treatment. (Appeal Letter, pp. 1-2; App. Opening Br., p. 1; App. Reply Br., p. 1.)

#### 10 Cost Basis

11 Appellant requests information and documentation that explains why the auditor  
12 established a cost basis of \$508,000, because at the time of the original purchase of the property, the  
13 county documents only listed the loan amount. Appellant contends that, if it is determined that he  
14 acquired the property as a gift, then the base price of the property should be \$950,000, which was the  
15 fair market value of the property at the time it was conveyed to him. (Appeal Letter, p. 1; App. Supp.  
16 Br., p. 2.)

17 Appellant contends that his cost basis of \$508,000 should be increased by \$75,000 to  
18 \$583,000. According to appellant, his parents paid his uncle and aunt \$75,000 because this is the  
19 amount of their equity in the property or, alternatively, this is one-half of \$150,000, the amount the  
20 property increased in value from the original price. Appellant also contends that the base price of  
21 \$508,000 should be increased by \$110,000 to \$618,000 because "part of the down payment made on this  
22 house was paid by trading the equity from their other house [See Exhibit VII]." Appellant asserts that  
23 the amount agreed upon was \$110,000, which is "real money" that "should have been included into the  
24 price of the house." Appellant attached to his reply brief a copy of a note secured by a deed of trust  
25 dated September 12, 1980, by which appellant's parents and uncle and aunt promise to pay the sum of  
26 \$115,000 (not \$110,000) to J.A. Johnson, Inc. on or before April 10, 1981, or upon the close of escrow  
27 of property located on White Oak Place in Danville, whichever may occur first. Appellant contends that  
28 the property's cost basis of \$618,000 should be increased by the \$75,000 his parents paid to his uncle

1 and aunt for their interest in the property buyout from his uncle for a cost basis of \$693,000. After  
2 applying the IRC section 121 tax exclusion of \$250,000, the improvement costs of \$41,279, and the  
3 settlement costs of \$46,342, appellant contends that the net cost basis would be \$1,030,621. Appellant  
4 also contends that the gain would be \$169,379 (\$1,200,000 (sales price) - \$1,030,621 (net cost basis)).  
5 Appellant asserts that, after subtracting \$116,895 of paid mortgage interest and property taxes  
6 deductions from the \$169,379 of gain, there would only be a net gain of \$52,484. (Appeal Letter, p. 1;  
7 App. Reply Br., p. 3., attachment.)

8 In addition, appellant contends that the property's cost basis should be increased for  
9 additional amounts of capital improvements. Appellant asserts that \$102,000 of improvements was  
10 made to the property from 1980 through 2003, but the auditor only allowed \$41,279. Appellant asserts  
11 that his family converted the property's three-car garage into a studio at an approximate cost of \$35,000.  
12 He states that the people who bought the house could verify that the conversion occurred. Appellant  
13 attached to his reply brief six receipts that he claims reflect improvements to the property not previously  
14 included. (Appeal Letter, p. 2; App. Reply Br., pp. 3-4, attachments; App. Supp. Br., pp. 1-2,.)

#### 15 Deductions

#### 16 Paid Mortgage Interest

17 In the appeal letter, appellant contends that, although the closing statement lists a total  
18 mortgage interest of \$92,527 consisting of interest of \$25,295 on a first mortgage (Washington Mutual  
19 Bank) and interest of \$67,232 on a second mortgage (LoanCare), respondent only allowed \$75,094 of  
20 paid mortgage interest deduction.<sup>5</sup> Appellant submitted copies of the Washington Mutual statement  
21 dated January 9, 2004, and a 2003 Form 1098 Mortgage Interest Statement from Washington Mutual,  
22 which lists (1) appellant's father, Syed B. Hassan, as the payer/borrower, (2) \$19,872.81 of mortgage  
23 interest received from the payer/borrower, and (3) \$6,962.04 of property taxes paid. Appellant also  
24 submitted a copy of the escrow statement, which lists, among other things, appellant as the seller, a  
25 settlement date of November 25, 2003, and \$75,093.72 of total mortgage interest paid on a first  
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27 \_\_\_\_\_  
28 <sup>5</sup> In the appeal letter, appellant asserts that only \$56,786 of a paid mortgage interest deduction was allowed by the protest unit, but in his opening brief, he asserts that the auditor and protest unit allowed \$75,094 of a paid mortgage interest deduction.

1 mortgage with Washington Mutual Bank (\$13,805.52) and a second mortgage with LoanCare  
2 (\$1,630.24 + \$59,657.96). (Appeal Letter, p. 2, attachment.)

3 In his reply brief, appellant contends that he is entitled to a total paid mortgage interest  
4 deduction of \$106,360 consisting of paid interest of \$19,872 plus additional expenses of \$11,716 on a  
5 first mortgage with Washington Mutual and paid interest of \$67,197 plus additional expenses of \$7,575  
6 on a second mortgage with Capital Alliance. Appellant submitted a copy of a 2003 Substitute Form  
7 1098 Mortgage Interest Statement from Capital Alliance, which lists appellant's mother, Azra B.  
8 Hassan, as the payer/borrower and \$67,191.46 of mortgage interest received from payer/borrower,  
9 including \$6,310.79 of late charges paid. Appellant also submitted another copy of the January 9, 2004  
10 Washington Mutual statement. (Appeal Letter, p. 2, attachments; App. Opening Br., p. 2; App. Reply  
11 Br., attachments.)

#### 12 Paid Property Taxes

13 In his appeal letter and opening brief, appellant contends that he is entitled to a paid  
14 property tax deduction of \$6,962, rather than the allowed amount of \$3,574.<sup>6</sup> Attached to the appeal  
15 letter is a copy of a 2003 Form 1098, Mortgage Interest Statement, from Washington Mutual Bank that  
16 lists \$6,962.04 of paid property taxes. (Appeal Letter, p. 2, Attachment; App. Opening Br., p. 2.) In his  
17 reply brief, appellant appears to assert that he is entitled to a total paid property tax deduction of  
18 \$10,535, consisting of the allowed amount of \$3,573 plus the \$6,962 amount of paid property taxes  
19 listed on the 2003 Form 1098 Mortgage Interest Statement from Washington Mutual. (Appeal Letter, p.  
20 2, attachment; App. Reply Br., p. 2, attachment.)

#### 21 Paid Business Losses

22 In his opening brief, appellant contends that he is entitled to an additional deduction  
23 because \$103,000 of the property sales proceeds were paid through escrow to Syed Bukhari, appellant's  
24 parents' business partner, to cover their share of the business losses. Appellant asserts that Mr. Bukhari  
25 agreed to apply the \$103,000 to pay the following expenses: 1) the rent owed to the landlord of the  
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27 <sup>6</sup> In his opening brief, appellant inadvertently referred to \$6,992 of paid property tax, rather than the \$6,962 amount listed on  
28 the 2003 Form 1098.

1 business location in Gilroy, California; 2) the balance owed to the owner of Tiger Motors; 3) the sales  
2 tax owed to this Board; and 4) the balance owed to Fireside Bank. According to appellant, Mr. Bukhari  
3 did not pay any of these expenses. Appellant argues that, if this paid business losses amount of  
4 \$103,000, which was paid through escrow, is allowed as a deduction, then there is a net capital loss.  
5 (App. Opening Br., pp. 2-3.)

#### 6 Statute of Limitations

7 Appellant argues that, on November 20, 2007, he “requested the state auditor to amend  
8 [his] taxes for 2003,” but the auditor would not permit it. According to appellant, the statute of  
9 limitations had not expired when he discussed amending his 2003 return with the auditor, but it expired  
10 before he began dealing with respondent’s protest unit. Appellant contends that Michael Colburn, an  
11 employee in respondent’s protest unit represented to him that “it was possible to allow for the 2003  
12 amendment, and the initial auditor, Nick Voorhees, “should have allowed [appellant] the amendment, in  
13 which my parents would have shown the sale of the house on their 2003 return.” He contends that, if the  
14 auditor had allowed him to amend his 2003 return, he would have had no tax liability from the property  
15 sale. According to appellant, if the 2003 amendment were allowed, his parents would have had a net  
16 price of \$502,658 after offsetting the \$1,200,000 sales price with \$697,347 of deductions, which consist  
17 of the following items: 1) a tax exclusion of \$500,000 (\$250,000 x 2); 2) the improvements of \$41,000;  
18 3) property tax and mortgage interest of \$110,000; and 4) settlement costs of \$46,342. Appellant further  
19 contends that the net price of \$502,658, less the cost basis of \$508,000, results in his parents having a  
20 net loss of \$5,347 (\$508,000 - \$502,658) and no tax liability. (Appeal Letter, pp. 1-2; App. Opening  
21 Br., p. 2; App. Reply Br., pp. 2-4.)

22 Appellant apparently argues that the statute of limitations for amending his 2003 return  
23 should have been tolled because it expired during the “negotiation process.” In his reply brief, appellant  
24 argues that a “stay” should be put on the statute of limitations because he began the process before the  
25 statute of limitations expired. Appellant compares his situation to a court case in which the statute of  
26 limitations expires during the trial period. He asserts, “But does the fact that we are currently in  
27 litigation postpone or prevent the statute from being enforced or expiring?” In his supplemental brief,  
28 appellant states, “I believe the statute should have been stayed, if not extended while the STATE made

1 its decisions.” Appellant asserts that respondent has failed to address the statute of limitations issue in  
2 its briefings and this issue is at the very basis of this appeal. (Appeal Letter, pp. 1-2; App. Opening Br.,  
3 p. 2; App. Reply Br., pp. 2-3; App. Supp. Br., pp. 1-3.)

#### 4 HOH Filing Status

5 Appellant contends that he should be entitled to amend his 2003 return to change his  
6 filing status from single to HOH and claim his parents as his dependents. Appellant asserts that the  
7 auditor and the protest unit indicated that if appellant owned the property and his parents were not  
8 working, then appellant’s parents become fully dependent on him. Appellant states, “[T]hen I should be  
9 allowed to show them as my dependents and thereby be considered head-of-household.” (App. Supp.  
10 Br., p. 2.)

#### 11 Respondent’s Contentions

12 Respondent contends that appellant acquired the property as a gift because he paid no  
13 consideration for it. Respondent asserts that, in 2000, appellant’s parents transferred the property to  
14 appellant and his mother via a gift deed, and then the property was transferred solely to appellant.  
15 Respondent contends that the property was intentionally transferred solely to appellant so that he could  
16 obtain a loan to pay for his mother’s medical bills, and he retained control of the property, even though  
17 his parents apparently paid some of the property taxes and remained liable for the mortgage.  
18 Respondent also contends that appellant continued to be the sole owner of the property until 2003 when  
19 it was sold to a third party. Respondent further contends that the recorded deeds for each transfer shows  
20 that appellant was the legal owner of the property prior to and at the time the property was sold to a third  
21 party. Respondent argues that appellant’s cost basis in the property equals his parents’ basis at the time  
22 the property was transferred to appellant because the transfer constitutes a gift to appellant. (Resp.  
23 Opening Br., pp. 5-6, fn. 32.)

24 Respondent asserts that appellant has not provided the original purchase price of the  
25 property, and the auditor used \$508,000 as appellant’s parents’ purchase price in an attempt to be  
26 reasonable. Respondent provided a copy of the Contra Costa County assessment record that lists the  
27 property’s value in October 1984 at \$508,250. Assuming the property was worth \$508,000 when  
28 appellant’s parents and uncle and aunt purchased it, respondent contends that appellant’s parents’ cost

1 basis was likely \$329,000, rather \$508,250, because appellant's parents would only have a cost basis of  
2 half of that amount, \$254,000 ( $\$508,250 \times 50\%$ ),<sup>7</sup> plus the \$75,000 they later paid to appellant's uncle  
3 and aunt to acquire the other half of the property. (Resp. Opening Br., pp. 1-3, 6, fn. 36, exhibit C.)

4           After reviewing the six receipts for improvements appellant submitted for the first time  
5 with his reply brief, respondent is adjusting appellant's cost basis and reducing the assessed amount of  
6 tax and the imposed late filing penalty. Respondent asserts that it is not allowing two of the submitted  
7 improvement receipts because one of them refers to mirrors, which is not an improvement that adds  
8 value to the residence or prolongs its useful life, and the other one does not provide any information  
9 other than an amount of \$232. With respect to the remaining four submitted receipts that refer to minor  
10 landscaping expenses totaling \$5,218, respondent states that, it is allowing "an increase in basis for these  
11 expenditures in an attempt to be reasonable," even though appellant has not shown that these  
12 landscaping improvements increased the value of the property. Respondent thus asserts on appeal that  
13 appellant is entitled to claim additional improvement expenses in the amount of \$5,218 plus the  
14 previously allowed amount of \$41,279 for total improvement expenses of \$46,407.<sup>8</sup> Based on this  
15 revised amount of improvements, respondent adjusted appellant's cost basis to \$554,407 (before taking  
16 into account selling expenses; and \$600,750 including selling expenses) and reducing the recognized  
17 capital gain to \$349,250. Respondent also states that it adjusted appellant's itemized deduction phase-  
18 out and his itemized deductions are revised by \$153 from \$64,746, the amount listed on the NOA, to  
19 \$64,593. Respondent thus reduced the assessed additional tax to \$26,218. In footnote 1 of its reply  
20 brief, respondent states that it is also reduced the failure to file penalty to \$6,555. (Resp. Opening Br.,  
21 p. 6; Resp. Reply Br., pp. 1-3, fn. 1.)

22           Respondent contends that appellant has otherwise failed to substantiate the \$110,000 of  
23 claimed improvements to the property. Respondent asserts that it cannot allow an increase in appellant's  
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25 <sup>7</sup> Staff notes that the precise amount is \$254,125, rather than \$254,000.

26 <sup>8</sup> In its reply brief, respondent inadvertently indicates that the four allowed items amount to \$5,218 when in fact they amount  
27 to \$5,128 ( $\$86.26 + \$1,011.80 + \$3,800.00 + \$230.00$ ). However, respondent's subsequent calculations of adjusted basis  
28 reflect the correct amount of \$5,128 (i.e., respondent allowed \$41,279 in improvements prior to appeal, \$5,128 of  
improvements during appeal, which total \$46,407 of improvements, which in turn is the total amount listed in its brief and  
used in its basis calculations).

1 cost basis for the conversion of the three-car garage into a studio, which appellant claims for the first  
2 time in his reply brief. Respondent contends that appellant has not provided any documentation to show  
3 the details or the cost of the conversion and it is insufficient for appellant to assert that neighbors can  
4 verify the conversion occurred. Respondent further contends that appellant has not established that this  
5 claimed conversion is not part of the \$41,279 of improvement costs, such as paint and windows, which  
6 the auditor previously allowed. (Resp. Opening Br., pp. 5-6; Resp. Reply Br, p. 2.)

7 In its reply brief, respondent contends that appellant incorrectly attributes a calculation of  
8 net gain as “according to auditor.” Respondent asserts that only the portion calculating total gain of  
9 \$354,378 appears to agree with the auditor’s calculations, but “the remaining calculations under  
10 ‘additional deductions’ appear to be appellant’s own calculations.” (Resp. Reply Br., p. 3.)

11 Respondent argues that appellant does not qualify for a mortgage interest deduction  
12 because the mortgages remained his parents’ debt. Respondent asserts that it nonetheless allowed  
13 appellant a mortgage interest deduction of \$75,094, because the escrow statement shows mortgage  
14 interest of \$75,094 was paid with proceeds from the property sale. Similarly, respondent asserts that it  
15 previously allowed appellant a deduction for property taxes paid in the amount of \$3,574, which were  
16 paid through escrow, but appellant has not shown that he paid any additional property taxes. (Resp.  
17 Opening Br., pp. 8-9.)

18 Respondent argues that appellant is not entitled to a reduction in the amount of his  
19 realized gain because he purportedly instructed the escrow officer to use a portion of the sale proceeds  
20 (\$103,000) to pay off a debt his mother owed her business partner, Mr. Bukhari. Citing the *Appeal of*  
21 *J.R. and Claudia Hengelmann* (86-SBE-132, decided on July 29, 1986)<sup>9</sup> and *United States v. Basye*  
22 (1973) 441 U.S. 441, 449-450, respondent contends that appellant was entitled to the sale proceeds and  
23 he cannot avoid a tax liability by assigning his income to another individual to satisfy his parents’ debt.  
24 Respondent states, “Appellant’s choice to apply the funds to someone else’s unrelated obligation does  
25 not entitle him to a decrease in the amount realized on the sale of the property.” Furthermore,  
26 respondent contends that appellant would not be entitled to a deduction for this payment because this  
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28 <sup>9</sup> Board of Equalization cases are generally available for viewing on the Board’s website ([www.boe.ca.gov](http://www.boe.ca.gov)).

1 debt was not his debt and the expenses were not incurred in a business belonging to appellant. (Resp.  
2 Opening Br., p. 7, fn. 38.)

3 Respondent argues that appellant is not entitled to an IRC section 121 tax exclusion of  
4 \$500,000 just because his parents would have been entitled to claim a \$500,000 tax exclusion if they,  
5 rather than appellant, reported the property sale on their 2003 return. It contends that it is irrelevant and  
6 incorrect for appellant to claim he was told that, if the statute of limitations had not expired, his parents  
7 would have been able to file an amended 2003 return to report the property sale. Respondent argues that  
8 the property was transferred to appellant intentionally and appellant voluntarily accepted title to the  
9 property. Respondent contends that, if appellant intended to transfer the property to his parents prior to  
10 the sale to a third party, he had ample time to do it, as he was the sole owner of the property for months  
11 and a partial owner for years prior to the sale to a third party. It also contends that appellant could have  
12 transferred title to the property to his father if his mother was sick. Assuming the statute of limitations  
13 had not expired, respondent asserts that appellant's parents would not have been able to report on their  
14 2003 return the capital gain from the property sale, because the capital gain can only be attributable to  
15 appellant, the sole owner of the property at the time the property was sold. Citing *Harris v. United*  
16 *States* (5th Cir. 1990) 902 F.2d 439, respondent states, "Taxpayers choose the form of their transactions  
17 and cannot recast those transactions in hindsight merely to achieve a different result for tax benefits."  
18 (Resp. Opening Br., pp. 7-8, fn. 39.)

19 Respondent provides the following calculation of the recognized capital gain, which  
20 incorporates its adjustments to the cost basis discussed above:

21	Sales Price	<u>\$1,200,000</u>
22	Selling Expenses	\$46,343
23	Purchase Price	\$508,000
24	Improvements	<u>\$46,407</u>
	Adjusted Basis	<u>\$600,750</u>
25	Sales Price	\$1,200,000
26	Adjusted Basis	<u>(\$600,750)</u>
27	Realized Gain	\$599,250
	IRC § 121 Exclusion	<u>(\$250,000)</u>
	Recognized Gain	<u>\$349,250</u>

28 (Resp. Reply Br., pp. 3-4.)

1 Respondent argues that, because appellant's parents are precluded from filing an  
2 amended 2003 return due to the running of the statute of limitations, appellant is also bound by the duty  
3 of consistency. Citing *Estate of Ashman v. Commissioner* (9th Cir. 2000) 231 F.3d 541, 543, respondent  
4 contends that the duty of consistency precludes a taxpayer from gaining an advantage by taking one  
5 position and later taking an incompatible position. (Resp. Opening Br., p. 8, fn. 40.)

6 With respect to the notation on appellant's 2003 return, which he filed on April 13, 2007,  
7 stating that respondent lost his original return, respondent contends that appellant did not provide a copy  
8 of any other filed 2003 return, it did not receive any payment of tax from appellant prior to April 13,  
9 2007, and appellant did not respond to the request for a tax return. As discussed above, respondent  
10 reduced the failure to file penalty to \$6,555 due to the revisions to the assessed additional tax.

11 Respondent does not discuss appellant's claim that he is entitled to use the HOH filing status on his  
12 2003 return. (Resp. Opening Br., p. 3, fn. 17; Resp. Reply Br., pp. 1, 3, fn. 1.)

### 13 Applicable Law

#### 14 Burden of Proof

15 Respondent has the initial burden of showing that its proposed assessment is reasonable  
16 and rational. Once this burden is met, respondent's determination is presumed correct and an appellant  
17 has the burden of proving it to be wrong. (*Todd v McColgan* (1949) 89 Cal.App.2d 509; *Appeal of*  
18 *Richard Byrd*, 84-SBE-167, Dec. 13, 1984.) It is well established that deductions from gross income are  
19 a matter of legislative grace, respondent's denials of deductions are presumed correct, and the burden is  
20 on the taxpayer to show by competent evidence that he is entitled to deductions claimed. (*Appeal of*  
21 *Gilbert W. Janke*, 80-SBE-059, May 21, 1980; *Appeal of James C. and Monablance A. Walshe*, 75-  
22 SBE-073, Oct. 20, 1975; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) To carry his burden  
23 of proof, a taxpayer must point to an applicable statute and show by credible evidence that the  
24 deductions he claims come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.)  
25 The taxpayer also bears the burden to prove that he is entitled to the HOH filing status. (*Appeal of*  
26 *Richard Byrd, supra.*) A taxpayer's unsupported assertions are insufficient to carry this burden of proof.  
27 (*Appeal of Aaron and Eloise Magidow*, 82-SBE-274, Nov. 17, 1982; *Appeal of Ismael R. Manriquez*,  
28 79-SBE-077, Apr. 10, 1979.) In the absence of uncontradicted, credible, competent, and relevant

1 evidence showing error in respondent's determinations, such assessments must be upheld. (*Appeal of*  
2 *Oscar D. and Agatha E. Seltzer*, 80-SBE-154, Nov. 18, 1980.) A taxpayer's failure to produce evidence  
3 that is within his control gives rise to a presumption that such evidence is unfavorable to his case.  
4 (*Appeal of Don A. Cookston*, 83-SBE-048, Jan. 3, 1983.)

#### 5 Capital Gain

6 IRC section 61, in defining gross income, includes income from gains derived from  
7 dealings in property.<sup>10</sup> IRC section 1001 provides that the gain on the sale of property shall be the  
8 excess of the amount realized over the adjusted basis of the property.<sup>11</sup> IRC section 1011 provides that  
9 the adjusted basis for determining gain from the sale of property shall be the property's initial basis  
10 (determined under IRC section 1012 or other applicable sections of that subchapter) adjusted as  
11 provided for in IRC section 1016. IRC section 1012 provides that the basis of property generally shall  
12 be the cost of such property. The amount realized includes the amount of an unpaid mortgage, whether  
13 or not the mortgage exceeds the value of the property. (Int.Rev. Code, § 1001(b); *Crane v.*  
14 *Commissioner* (1947) 331 U.S. 1; *Commissioner v. Tufts* (1983) 461 U.S. 300.)

15 A taxpayer is taxed on the capital gain he realizes from the sale of property, regardless of  
16 whether he assigns proceeds from the property sale to satisfy the debt of another individual. The  
17 assignment of income doctrine provides that income is ordinarily taxed to the person who earns it, and  
18 that the incidence of income taxation may not be shifted by anticipatory assignments. (*Lucas v. Earl*  
19 (1930) 281 U.S. 111, 114-115.) In the *Appeal of J.R. and Claudia Hengelman, supra*, the Board held  
20 that a taxpayer remained subject to income tax on wages he earned after he claimed to have sold his  
21 personal services property assets to a third party. Citing *Commissioner v. Culbertson* (1949) 337 U.S.  
22 733, 739, the Board stated, "It is a fundamental principle of income taxation that income must be taxed  
23 to the one who earns it."

24 Where property has been transferred to another as a gift, there generally is no recognition  
25 of gain under the tax law, but the gifted property has a tax basis in the hands of the recipient equal to its  
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27 <sup>10</sup> California conforms to IRC section 61 at Revenue and Taxation Code (R&TC) section 17071.

28 <sup>11</sup> California conforms to IRC sections 1001 and 1011-1016 at R&TC section 18031.

1 tax basis in the hands of the donor; that is, the gifted property gets a carryover tax basis in the hands of  
2 the recipient. (Int.Rev. Code, § 1015(a).) If the recipient does not know the facts necessary to  
3 determine the property’s basis in the hands of the donor or the last preceding owner, “the Secretary  
4 shall, if possible obtain such facts from such donor or last preceding owner, or any other person  
5 cognizant thereof.” (*Id.*) If it is impossible for the Secretary to ascertain such facts, “the basis in the  
6 hands of such donor or last preceding owner shall be the fair market value of such property as found by  
7 the Secretary as of the date or approximate date at which, according to the best information that the  
8 Secretary is able to obtain, such property was acquired by such donor or last preceding owner.” (*Id.*)

9 Under IRC section 1016, a property’s initial basis must be adjusted for capital additions.  
10 Capital additions, such as the cost of capital improvements made to the property by the taxpayer,  
11 increase the initial basis so that on the date of disposition the adjusted basis reflects the unrecovered cost  
12 or other basis of the property. (Int.Rev. Code § 1016(a).) Capital expenditures are generally not  
13 deductible. (Int.Rev. Code, § 263; Treas. Reg. § 1.213-1(e)(1)(iii).) In contrast, expenditures for the  
14 ordinary repair and maintenance of property are deductible in the current taxable year if such  
15 expenditures are related to business or income-producing property. (Int.Rev. Code §§ 162 and 212;  
16 Rev. & Tax Code, § 17201.)

#### 17 IRC Section 121 Tax Exclusion

18 Under IRC section 121,<sup>12</sup> as in effect in 2003, a taxpayer can exclude up to \$250,000 of  
19 gain on the sale of a home, if the taxpayer meets the following conditions:

- 20 • Owned the home for at least two years during the five-year period ending on the date of the sale  
21 (“ownership test”);
- 22 • Used the home as his or her principal residence for at least two years during the 5-year period  
23 ending on the date of the sale (“use test”); and
- 24 • Did not exclude gain from the sale of another home during the two-year period ending on the  
25 date of the sale.

26  
27  
28 <sup>12</sup> California conforms to IRC section 121 with modifications at R&TC section 17152.

1 Taxpayers who are married can exclude up to \$500,000 of the gain on the sale of a home,  
2 if they meet the following conditions:

- 3 • The taxpayers file a joint return for the year of the sale;
- 4 • Either spouse meets the ownership test (as set forth above);
- 5 • Both spouses meet the use test (as set forth above); and
- 6 • Neither spouse excluded gain from the sale of a home during the two-year period ending on the  
7 date of the sale.

8 (Int.Rev. Code, § 121(a) & (b).)

### 9 Mortgage Interest Deductions

10 IRC section 163(h)(1)<sup>13</sup> generally disallows a deduction for personal interest. There is an  
11 exception to this rule in the case of a qualified residence interest. (Int.Rev. Code, § 163(h)(2)(D).)  
12 Qualified residence interest includes interest paid or accrued during the taxable year on acquisition  
13 indebtedness. (Int.Rev. Code, § 163(h)(3)(A).) Acquisition indebtedness means any indebtedness that  
14 is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer  
15 and is secured by the residence. (Int.Rev. Code, § 163(h)(3)(B)(i).) A qualified residence includes the  
16 principal residence of the taxpayer. (Int.Rev. Code, § 163(h)(4)(A).)

17 For interest on a mortgage to be deductible, the indebtedness generally must be an  
18 obligation of the taxpayer and not an obligation of another. (*Smith v. Commissioner* (1985) 84 T.C. 889,  
19 897, affd. without published opinion 805 F.2d 1073 (D.C. Cir. 1986).) However, Treasury Regulation  
20 section 1.163-1(b) provides, “Interest paid by the taxpayer on a mortgage upon real estate of which he is  
21 the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note  
22 secured by such mortgage, may be deducted as interest on his indebtedness.” The courts have  
23 disallowed a taxpayer’s claimed mortgage interest deduction in cases in which the taxpayer has not  
24 shown legal, equitable, or beneficial ownership of property. (*Hynes v. Commissioner*, 74 T.C. 1266,  
25 1288 (1980); *Song v. Commissioner*, T.C. Memo 1995-446; *Bonkowski v. Commissioner*, T.C. Memo.  
26 1970-340, affd. 458 F.2d 709 (7th Cir. 1972).)

27 \_\_\_\_\_  
28 <sup>13</sup> California conforms to IRC sections 163 and 164 at R&TC section 17201.

1                   Real Property Taxes

2                   IRC section 164(a) provides for a deduction for real property taxes and other specified  
3 taxes paid or accrued by the taxpayer during the taxable year. (See *Ostrow v. Comm’r* (2004) 122 T.C.  
4 378.) Real property taxes are those taxes imposed on interests in real property and levied for the general  
5 public welfare. (Treas. Reg. § 1.164-3(b).)

6                   Duty of Consistency

7                   The United States Supreme Court has held that “...while a taxpayer is free to organize his  
8 affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his  
9 choice, whether contemplated or not.” (*Commissioner v. Nat’l Alfalfa Dehydrating & Milling Co.*  
10 (1974) 417 U.S. 134, 149.) The duty of consistency was discussed by the Ninth Circuit Court of  
11 Appeals in *Estate of Ashman v. Commissioner, supra*, 231 F. 3d 541, 543 as follows:

12                   While it is true that income taxes are intended to be settled and paid annually each year standing  
13 to itself, and that omissions, mistakes and frauds are generally to be rectified as of the year they  
14 occurred, this and other courts have recognized that a taxpayer may not, after taking a position in  
15 one year to his advantage and after correction for that year is barred, shift to a contrary position  
16 touching the same fact or transaction.

17                   The Ninth Circuit identified the following three elements for meeting the duty of  
18 consistency:

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

25 (*Id.* at p. 546 [quoting *Herrington v. Comm’r* (5<sup>th</sup> Cir. 1988) 854 F.2d 755, 758 and citing additional  
26 authorities].)

27                   Statute of Limitations on Refund Claims

28                   R&TC section 19306 provides that a claim for refund is permitted if made within either  
of the following two periods, whichever is later: (1) four years from when the return was timely filed or  
four years from the last day prescribed for the filing of the return (determined without regard to any  
extension of time for filing the return); or (2) one year from the time of the actual payment. A  
taxpayer’s failure to file a claim for refund/credit within the statutory period prevents the taxpayer from

1 doing so at a later date. (*Appeal of Richard M. and Claire P. Hammerman*, 83-SBE-260, December 13,  
2 1983) The Board consistently has held that the statute of limitations on claims for refund is explicit and  
3 must be strictly construed. (*Appeal of James C. and Florence Meek*, 2006-SBE-001, March 28, 2006.)

#### 4 Statute of Limitations on Deficiency Assessments

5 R&TC section 19057, subdivision (a), provides that, except in the case of a false or  
6 fraudulent return and except as otherwise provided, a deficiency assessment must be issued within four  
7 years after the return is filed. When no return is filed, the statute of limitations never begins to run.  
8 (Rev. & Tax Code, § 19087, subd. (a). See also Int.Rev. Code, § 6501(c)(3).)

#### 9 HOH Filing Status

10 R&TC section 17042 sets forth the requirements for the HOH filing status by reference  
11 to IRC section 2(b). Thus, California law is the same as federal law on this issue. As in effect in  
12 2003, IRC section 2(b) provides in relevant part that the taxpayer must be unmarried (at the close of  
13 the taxable year), and must maintain a household that constitutes the principal place of abode of the  
14 taxpayer's father or mother, if the taxpayer is entitled to a deduction for the taxable year for such  
15 father or mother under IRC section 151. (Int.Rev. Code, § 2(b)(1)(B).) The taxpayer shall be  
16 considered as maintaining a household only if he furnishes half the cost of maintaining the household  
17 during the taxable year. (*Id.*)

18 To qualify as a taxpayer's dependent, an individual must meet each of the applicable  
19 requirements set forth in IRC sections 151(c) and 152, as in effect in 2003. The list of potential  
20 qualifying individuals for the dependent exemption credit includes the taxpayer's father or mother, as  
21 listed in IRC section 152, subsections (a)(4). (Int.Rev. Code, §§ 2(b), 152(b).) The term "dependent"  
22 does not include any individual who is not a citizen or national of the United States, unless the  
23 individual is a resident of the United States, Canada, or Mexico. (Int.Rev. Code, § 152(b)(3).) A  
24 dependent exemption credit will generally not be allowed for any individual who has made a joint  
25 federal return with his spouse for the tax year at issue. (Int.Rev. Code, § 151(c)(2).) The individual's  
26 gross income must be less than the allowable federal dependent exemption amount; in 2003, the federal  
27 exemption amount was \$3,050. (Int.Rev. Code, § 151(c)((1)(A).) The taxpayer must have provided  
28 more than half of the individual's support for the calendar year. (Int.Rev. Code, § 152(a).)

1 R&TC section 18521, subdivision (a)(1), as in effect in 2003, provides that an individual  
2 shall use the same filing status that he or she used on his or her federal income tax return filed for the  
3 same taxable year. R&TC section 18521, subdivision (a)(2), as in effect in 2003, provides, however,  
4 that if respondent determines that the filing status used on the taxpayer's federal income tax return was  
5 incorrect, it may revise the return to reflect a correct filing status.

6 STAFF COMMENTS

7 Appellant has the burden of proving that he is entitled to a greater cost basis than that  
8 calculated by the FTB, which on appeal has allowed a total cost basis of \$600,750 (\$554,407, plus  
9 selling expenses). Appellant will want to point to documentation which establishes the price paid to  
10 acquire the property in 1980 and/or through any later transactions, and the cost of any improvements not  
11 already included in the adjusted basis allowed by the FTB.<sup>14</sup>

12 Without documentation supporting the original acquisition price of the property, it is not  
13 clear that appellant's adjusted basis would exceed the \$600,750 adjusted basis (including selling  
14 expenses) already allowed by the FTB, even after taking into account the \$75,000 apparently paid by  
15 appellant's parents in 1983, and even if appellant established additional basis, in the amount of \$110,000  
16 claimed by him with respect to an "equity exchange", and any additional amounts claimed for  
17 improvements. In this regard, appellant will want to (1) explain how the documentation in the record  
18 substantiates his assertion that he should receive a basis of \$110,000 based on an "equity exchange" by  
19 his parents and (2) address whether, if such a basis increase is merited, how the total basis he calculates  
20 would exceed the amount already allowed by the FTB.

21 To the extent appellant seeks additional mortgage expense deductions beyond the  
22 \$75,094<sup>15</sup> amount that is reflected in the escrow closing statement and has already been allowed by the  
23 FTB, he should be prepared to identify or provide supporting evidence which demonstrates that any

24 \_\_\_\_\_  
25 <sup>14</sup> Prior to appeal, the FTB allowed a \$41,279 increase in basis for improvements. As noted in footnote 7, during appeal, the  
26 FTB agreed to also allow an additional increase in basis for four additional expenditures receipts for landscaping which were  
27 provided during appeal (\$86.26 + \$1,011.80 + \$3,800.00 + \$230.00). These additional allowed items total \$5,128 (rounding  
to the nearest dollar).

28 <sup>15</sup> The closing statement is attached to appellant's appeal letter and reflects interest of \$13,805.52, \$1,630.24, and \$59,657.96,  
which totals \$75,093.72 and the FTB has rounded this amount to \$75,094.

1 additional expenses were paid by him and not already included in the \$75,094 amount. Similarly,  
2 appellant will want to demonstrate that he paid the property tax not already allowed by the FTB. (The  
3 FTB has allowed a property tax deduction of \$3,574 while appellant has provided a Form 1098  
4 indicating that property tax of \$6,962.04 was paid. However, the Form 1098 lists appellant's father as  
5 the payor.)

6 Appellant appears to argue that his parents should be permitted to file an amended tax  
7 return to report themselves as the sellers of the property so that they can take advantage of the full  
8 \$500,000 exclusion of gain rather than the \$250,000 exclusion of gain available to appellant  
9 individually. However, it appears to staff that the ultimate issue is not whether an amended return can  
10 be filed, but whether appellant has demonstrated that he was not the actual owner and seller of the  
11 property. To address this issue, appellant will want to explain further, with supporting evidence, why  
12 his parents should be deemed to be the beneficial owners and sellers of the property when he held legal  
13 title and evidently received the net sale proceeds of \$83,999.41 from the escrow company. Appellant  
14 will also want to explain why, if his parents were the actual owners and sellers, they did not report the  
15 sales transaction on their original tax returns. Respondent will want to address the fact that appellant's  
16 parents apparently paid some mortgage and property expenses on the property.

17 If either party has any additional evidence to provide, staff requests that, pursuant to  
18 section 5523.6 of the Rules for Tax Appeals (Cal. Code Regs., tit. 18, § 5523.6), such evidence be  
19 provided to the Board's Board Proceedings Division at least 14 days prior to the hearing, in order to  
20 facilitate a productive hearing.

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