



1 property to appellant; appellant did not produce a copy of any grant deed reflecting this transfer of title.<sup>1</sup>  
2 Mr. Bautista is the sole shareholder of appellant, a California C corporation.<sup>2</sup> On July 17, 2007,  
3 appellant reportedly sold the property to a third party by a grant deed for a sales price of \$680,000;  
4 appellant did not produce a copy of this grant deed. (Resp. Opening Brief, pp. 1-2, Exhibit B.)

5 Appellant reportedly filed a California corporate income tax return for 2007. On its 2007  
6 Schedule D-1, Sale of Business Property, appellant reportedly claimed an ordinary loss of \$1,200 from  
7 the sale of the property on August 21, 2007, based on the difference between the gross sale price of  
8 \$680,000 and the cost/basis of \$681,200.<sup>3</sup> Respondent subsequently requested that appellant  
9 substantiate its claimed basis of \$681,200. Appellant provided respondent with a copy of a settlement  
10 statement related to the property sale, which shows a gross amount of \$680,000.00 due to seller and lists  
11 the payoff of a first mortgage loan of \$439,338.44, the payoff of a second mortgage loan of  
12 \$117,064.08, \$118,443.53 of settlement charges to seller, and miscellaneous payments of \$5,153.95. A  
13 copy of the settlement statement is attached to appellant's opening brief. After reviewing the various  
14 items comprising these claimed settlement charges, the auditor allowed all but the following claimed  
15 expenses (which total \$101,651.03):

16 Early Release of funds per amendment to SC Brokers Inc.	\$20,400.00
17 Transaction coordinator fee to Norma Bautista	\$350.00
18 Creditor payment to Alfredo Bautista	\$68,500.00
19 Creditor payment to Jose Munoz	\$10,000.00
20 Creditor payment to Jose Vargas	\$2,401.03

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26 <sup>1</sup> Schedule D-1 on appellant's 2007 California corporate income tax return reportedly indicates that appellant acquired the  
property on May 4, 2007.

27 <sup>2</sup> The California Secretary of State's Office's public records show that appellant (entity number C2693936) was incorporated  
28 on December 15, 2004, and was dissolved on an undisclosed date.

<sup>3</sup> There is no copy of appellant's 2007 return, including the Schedule D-1, in the appeal record.

1 Respondent reportedly issued a Notice of Proposed Assessment (NPA) dated June 22, 2010.<sup>4</sup> In an  
2 undated letter, Mr. Bautista protested the NPA. Respondent apparently held a protest hearing at which  
3 time “[t]he only area of dispute concerned the selling expenses disallowed by the auditor listed above.”  
4 Mr. Bautista stated that he was not able to produce cancelled checks related to the disallowed claimed  
5 selling expenses because the account was closed and the bookkeeper was unable to locate relevant bank  
6 statements, and some of the disallowed claimed selling expense constituted the repayment of loans. The  
7 hearing officer reportedly informed Mr. Bautista that undocumented loan repayments are not includable  
8 in the selling expenses and do not increase the property’s cost basis. Appellant did not provide any  
9 additional information after the protest hearing. (App. Opening Br., attachment; Resp. Opening Br.,  
10 pp. 2-4, exhibit D.)

11 Respondent issued a Notice of Action (NOA) dated December 19, 2011, revising the  
12 NPA. The NOA increased the corporation’s reported net income of -\$8,771.00 by \$107,655.50 by  
13 disallowing the claimed ordinary loss of \$1,200.00 and including ordinary gain of \$106,455.50. The  
14 NOA assesses additional tax of \$7,174. (Resp. Opening Br., p. 4, exhibit E.)

15 This timely appeal followed.

16 Request for Additional Briefing

17 In order to further develop the issues, the Appeals Division requested additional briefing  
18 by letter dated August 22, 2012, in which appellant was requested to submit the following:

19 Appellant is asked to provide any evidence not yet provided that supports its calculation  
20 of the gain, if any, on the sale of the property. Appellant is also asked to describe in  
21 detail each piece of evidence, explaining how it supports its theory, and provide a  
22 detailed calculation of the net capital gain or loss on the property including the purchase  
23 date and price, any adjustments to appellant’s basis in the property, and the expenses  
24 related to the sale of the property. Appellant should be sure to focus on the selling  
25 expenses disallowed by respondent, and explain why the claimed loan repayments  
26 reduced any gain in the sale of the property. Please provide documents in English where  
27 available, and provide translations of any non-English documents.

28 The parties submitted responsive additional briefings, which are discussed below.

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<sup>4</sup> There is no copy of the NPA in the appeal record.

1           Contentions

2           Appellant's Contentions

3           In its opening brief, appellant contends that it owes no additional tax because there were  
4 no gains on the sale of the property. Appellant refers to its contentions that are set forth in a letter dated  
5 March 3, 2010, addressed to respondent, which sets forth appellant's history of the facts surrounding the  
6 purchase, operation, and ultimate sale of the property. Appellant previously submitted to the auditor the  
7 March 3, 2010 letter, as well as copies of documents, including the settlement statement, utility bills,  
8 personal checks, and bank statements in Spanish. In this letter, Mr. Bautista contends that appellant did  
9 not profit from the sale of the property. He asserts that the former owner of the property is a real estate  
10 agent who deceived him. He also asserts that the former owner informed him that the property collected  
11 enough rental income to pay the overdue mortgage payments. Specifically, the former owner (Elizabeth  
12 Marando) reportedly told him that she was collecting monthly rental income of \$5,400 and the payment  
13 was \$4,200. Mr. Bautista further asserts that the former owner "claimed to have fallen behind because  
14 she needed to make the payment for the house where she was living," one unit at the property was  
15 vacant, and one of her tenants was in arrears in his rent. According to Mr. Bautista, the former owner  
16 "insisted she had no paperwork for the payment or balance due because the Bank was no longer sending  
17 payment coupons." In this letter, Mr. Bautista contends that, at the time he and his brother decided to  
18 acquire the property, it was being foreclosed upon and the scheduled trustee sale was in a few days. He  
19 asserts that the former owner requested \$10,000 from him to transfer title, which he paid in stages.  
20 (App. Opening Br., attachment.)

21           Mr. Bautista also asserts that on May 1, 2007, he sent a cashier's check for \$49,563.39 to  
22 Countrywide, which only satisfied the back due payments on the first loan, and he subsequently began to  
23 receive the payment coupons. He further asserts that there was a "substantial second lien on the  
24 property, which had NOT been paid in a long time," and this second lien was not previously disclosed.  
25 In this letter, Mr. Bautista describes unpaid utility bills and the repairs required to place the property on  
26 the market for sale. He also discusses the fact that he borrowed, on behalf of appellant, money from  
27 equity lines, friends, and family, and his own personal bank account to satisfy the encumbrances on the  
28 property and to pay for expenditures involved with operating the property and preparing it for sale.

1 (App. Opening Br., attachment.)

2 Appellant asserts that the auditor was ill-prepared when she audited its 2007 return.  
3 According to appellant, the auditor “had no answers to our questions,” she was not sure of what she was  
4 investigating, and after spending five hours reviewing appellant’s paperwork, she did not finish.  
5 Appellant states, “I have offered substantial proof, which is being disallowed.” Appellant asserts that,  
6 when it informed the auditor that it does not have a contract or escrow papers to substantiate the cost  
7 basis, the auditor ultimately requested proof of its expenses. Appellant contends that after it submitted  
8 the requested proof of its expenses, the auditor informed it “that it was too late for [the] expenses to be  
9 taken into account.” (App. Opening Br.)

10 In response to the request for additional briefing, appellant submitted a letter dated  
11 October 16, 2012, in which it states, “[T]his letter and the accompanied package is my response.” It  
12 further states that it “previously sent in a response which was returned to me, the letter is enclosed.”  
13 Attached to the October 16, 2012 letter are copies of a letter from Board staff dated May 10, 2012,  
14 appellant’s opening brief, Mr. Bautista’s May 3, 2010 letter, and the same documents submitted during  
15 the audit. (App. Reply. Br.)

16 In a supplemental brief, appellant contends that it disagrees with the proposed  
17 assessment. It requests advice as to how to proceed with an oral hearing. Appellant states, “The  
18 packages that [have] been submitted details and documents all of the expense related to this property.”  
19 It asserts that it is willing to “connect the dots and walk everyone through a timeline that would help you  
20 understand my position.” (App. Supp. Br.)

#### 21 Respondent’s Contentions

22 Respondent contends that appellant has not established that it is entitled to a decrease in  
23 the capital gain resulting from the sale of the property. Respondent asserts that Mr. Bautista is an  
24 experienced licensed real estate agent who worked many years at Coldwell Banker. Citing *O’Neill v.*  
25 *Commissioner* (9th Cir. 1959) 271 F.2d 44, respondent asserts that, even if it is difficult to establish,  
26 appellant has the burden to produce reliable and precise evidence to substantiate its reported basis.  
27 Respondent asserts that it allowed the documented expenses of sale in calculating the adjusted basis and  
28 thus correctly computed appellant’s capital gain on the sale of the property. Respondent argues that

1 “[a]ppellant has not provided any information to establish that the disallowed selling expenses were  
2 made, much less any legal basis why these ‘loan repayments’ would reduce the capital gain arising from  
3 the sale.” (Resp. Opening Br., pp. 1, 4-6.)

4 In its reply brief, respondent contends that appellant has not substantiated that the  
5 disallowed selling expenses were paid and it has provided no legal authority for allowing the disallowed  
6 selling expenses. According to respondent, the submitted documents, such as utility bills, bank  
7 statements, cancelled checks, notice of trustee’s sale, and a debit statement which shows that  
8 Mr. Bautista had a line of credit with Bank of America, are not in dispute and they do not “relate to or  
9 substantiate the purported loan repayments that appellant treated as selling expenses.” Respondent  
10 asserts that the copies of sixteen cancelled checks from Mr. Bautista to appellant fail to establish  
11 anything “more than Mr. Bautista loaning his wholly owned corporation operating funds.” According to  
12 respondent, the three cancelled checks from Mr. Bautista for the payment of a \$500 utility bill, \$400  
13 worth of carpet, and a payment of \$1,000 to Sergio Rodriguez for “services” do not show that appellant  
14 is entitled to an increase in cost basis. Respondent also asserts that the nine pages of bank statements in  
15 Spanish indicate that a loan existed on the property and that interest was paid. Respondent contends that  
16 this is not in dispute as the auditor allowed an increase in basis for the first and second mortgage.  
17 Respondent also contends that appellant did not provide documents showing that a loan existed between  
18 appellant and third parties, and that it made payments on these loans. In addition, respondent asserts that  
19 appellant could have explained, as requested in the Board’s August 22, 2012 letter, why the claimed  
20 loan repayments reduced any gain in the sale of the property, but has failed to do so. (Resp. Reply Br.,  
21 pp. 2-3.)

## 22 Applicable Law

### 23 Burden of Proof

24 Respondent has the initial burden of showing that its proposed assessment is reasonable  
25 and rational. Once this burden is met, respondent’s determination is presumed correct and an appellant  
26 has the burden of proving it to be wrong. (*Todd v McColgan* (1949) 89 Cal.App.2d 509; *Appeal of*  
27 *Richard Byrd*, 84-SBE-167, Dec. 13, 1984.) It is well established that deductions from gross income are  
28 a matter of legislative grace, respondent’s denials of deductions are presumed correct, and the burden is

1 on the taxpayer to show by competent evidence that it is entitled to deductions claimed. (*Appeal of*  
2 *Gilbert W. Janke*, 80-SBE-059, May 21, 1980; *Appeal of James C. and Monablance A. Walshe*,  
3 *75-SBE-073*, Oct. 20, 1975; *New Colonial Ice Co. v. Helvering* (1934) 292 U.S. 435.) To carry its  
4 burden of proof, a taxpayer must point to an applicable statute and show by credible evidence that the  
5 claimed deductions come within its terms. (*Appeal of Robert R. Telles*, 86-SBE-061, Mar. 4, 1986.) A  
6 taxpayer's unsupported assertions are insufficient to carry this burden of proof. (*Appeal of Aaron and*  
7 *Eloise Magidow*, 82-SBE-274, Nov. 17, 1982; *Appeal of Ismael R. Manriquez*, 79-SBE-077, Apr. 10,  
8 1979.) In the absence of uncontradicted, credible, competent, and relevant evidence showing error in  
9 respondent's determinations, such assessments must be upheld. (*Appeal of Oscar D. and Agatha E.*  
10 *Seltzer*, 80-SBE-154, Nov. 18, 1980.) A taxpayer's failure to produce evidence that is within its control  
11 gives rise to a presumption that such evidence is unfavorable to its case. (*Appeal of Don A. Cookston*,  
12 83-SBE-048, Jan. 3, 1983.)

### 13 Capital Gain

14 Internal Revenue Code (IRC) section 61, in defining gross income, includes income from  
15 gains derived from dealings in property.<sup>5</sup> IRC section 1001 provides that the gain on the sale of  
16 property shall be the excess of the amount realized over the adjusted basis of the property.<sup>6</sup> IRC section  
17 1011 provides that the adjusted basis for determining gain from the sale of property shall be the  
18 property's initial basis (determined under IRC section 1012 or other applicable statutes in that  
19 subchapter) adjusted as provided for in IRC section 1016. IRC section 1012 provides that the basis of  
20 property generally shall be the cost of such property. The amount realized includes the amount of an  
21 unpaid mortgage, whether or not the mortgage exceeds the value of the property. (Int.Rev. Code,  
22 § 1001(b); *Crane v. Commissioner* (1947) 331 U.S. 1; *Commissioner v. Tufts* (1983) 461 U.S. 300.)

23 Where property has been transferred to another as a gift, there generally is no recognition  
24 of gain under the tax law, but the gifted property has a tax basis in the hands of the recipient equal to its  
25 tax basis in the hands of the donor; that is, the gifted property has a carryover tax basis in the hands of  
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27 <sup>5</sup> California conforms to IRC section 61 at Revenue and Taxation Code (R&TC) section 17071.

28 <sup>6</sup> California conforms to IRC sections 1001 and 1011-1016 at R&TC section 18031.

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

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

#### 16 STAFF COMMENTS

17 Appellant has the burden of substantiating that it is entitled to a cost basis in excess of the  
18 cost basis allowed at audit. At the oral hearing, appellant should be prepared to explain how it  
19 calculated a reported cost basis of \$681,200. At the oral hearing, appellant should be prepared to discuss  
20 why it is entitled to include the disallowed claimed loan repayments and the transaction coordinator fee  
21 to Norma Bautista in its cost basis and how the submitted documents relate to or substantiate an  
22 entitlement to these claimed amounts.

23 As stated in respondent’s opening brief, “It appears Mr. Bautista did not pay for or  
24 exchange any consideration for the title[,]” and details have not been provided concerning the transfer of  
25 the property from Mr. Bautista to appellant. The parties should be prepared to discuss whether  
26 Mr. Bautista and/or appellant obtained title to the property as a gift, which would mean that appellant  
27 receives a carryover tax basis in the property.

28 Respondent may wish to clarify whether or not it included the \$350 transaction

1 coordinator fee to Norma Bautista in appellant's adjusted cost basis. Based on the NOA, it appears that  
2 respondent allowed it to be included in the cost basis but respondent's opening brief appears to state  
3 otherwise. Respondent's opening brief indicates that 1) it allowed appellant an adjusted cost basis of  
4 \$573,195.02 consisting of the payoff of the first mortgage loan of \$439,338.44, the payoff of the second  
5 mortgage loan of \$117,064.08, and \$16,792.50 of charges listed on the settlement statement, and  
6 2) respondent disallowed \$101,301.03 of claimed loan repayments plus the \$350.00 transaction  
7 coordinator fee to Norma Bautista. (Resp. Opening Br., pp. 2-3, exhibit E.) It appears that appellant's  
8 ordinary gain should thus amount to \$106,804.98, which is the difference between the undisputed gross  
9 sale price of \$680,000.00 and the allowed adjusted basis of \$573,195.02. Yet, the NOA lists a net  
10 income adjustment for an ordinary gain of \$106,455.50, as well as a disallowance for the reported loss  
11 of \$1,200.00. It thus appears that respondent understated appellant's assessment because it increased  
12 appellant's ordinary gain by only \$106,455.50, rather than \$106,804.98. Appeals Division staff notes  
13 that the difference in ordinary gain is \$349.48, which, when rounded up, is the disallowed claimed  
14 expense amount for the transaction coordinator fee to Norma Bautista (i.e., \$350.00). In its opening  
15 brief, respondent later states that it allowed the payoff mortgages of \$556,402 and documented selling  
16 expenses of \$17,142, which would indicate that it allowed the \$350 transaction coordinator fee to  
17 Norma Bautista, notwithstanding the fact it is not reflected in the NOA. (Resp. Opening Br., p. 4.)

#### 18 Additional Evidence

19 If appellant has any additional evidence to provide, Appeals Division staff requests that,  
20 pursuant California Code of Regulations, title 18, section 5523.6, it should be submitted to the Board  
21 and respondent at least 14 days prior to the hearing date.<sup>7</sup>

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25 SC Brokers Inc\_if  
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28 <sup>7</sup> Exhibits should be submitted to: Claudia Madrigal, Board Proceedings Division, Board of Equalization. P. O. Box 942879 MIC: 80, Sacramento, CA 94279-0080.