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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re:)	BAP Nos.	SC-07-1283-KMkDo
)		SC-07-1394-KMkDo
ROBERT K. ADAMS,)		(Consolidated)
)		
Debtor.)	Bk. No.	94-01921
_____)		
)		
FRANCHISE TAX BOARD OF THE)		
STATE OF CALIFORNIA,)		
)		
Appellant,)		
)		
v.)	MEMORANDUM*	
)		
RICHARD M. KIPPERMAN, Chapter)		
7 Trustee; JUDITH ADAMS,)		
)		
Appellees.))		
_____)		

Argued and Submitted on January 23, 2008
at San Diego, California

Filed - February 7, 2008

Appeal from the United States Bankruptcy Court
for the Southern District of California

Honorable Peter W. Bowie, Chief Bankruptcy Judge, Presiding

Before: KLEIN, MARKELL and DONOVAN,** Bankruptcy Judges.

*This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

**Hon. Thomas B. Donovan, United States Bankruptcy Judge for the Central District of California, sitting by designation.

1 This is an appeal from an order sustaining the chapter 7
2 trustee's objection to a tax claim filed on behalf of the
3 California Franchise Tax Board ("FTB") pursuant to 11 U.S.C.
4 § 501(c). Appellant, the FTB, argues that the debtor and his
5 former spouse owe taxes for tax year 1993 based on multiple
6 modifications made to three promissory notes that encumbered
7 certain real property owned by the couple's partnership.
8 Appellees, the chapter 7 trustee and the former spouse, each
9 dispute the alleged tax assessment of the debtor (hence, the
10 bankruptcy estate) and the former spouse. The court held that
11 the various modifications between 1987 and 1993 made to the notes
12 did not trigger taxable gain and taxable discharge of
13 indebtedness for 1993. We AFFIRM.

14
15 FACTS

16 Debtor Robert Adams and his former spouse, appellee Judith
17 Adams, own an interest in Trails partnership,¹ a limited
18 partnership that had as its sole asset an apartment complex in
19 Dallas, Texas. The partnership purchased the property in October
20 1982 and sold it on February 10, 1993.²

21 As part of the consideration for purchase of the property in
22 1982, the partnership executed a Wraparound Promissory Note to

23
24 ¹Judith was a limited partner owning a 90 percent interest
25 in the partnership, which was formed under Texas law on October
26 28, 1982. During 1992 and 1993, Pacific/Trails Associates, Inc.,
27 a Texas corporation, was the general partner of the partnership
and owned the other 10 percent interest. The interest in the
partnership was the community property of Robert and Judith.

28 ²The partnership's property was purchased for about \$9
million, the fair market value as of the date of purchase.

1 the seller. Underlying the Wraparound Note were two promissory
2 notes, the First Note and Second Note, secured by a First Trust
3 Deed and Second Trust Deed, respectively. The Wraparound Note,
4 the First Note, and the Second Note were all without recourse to
5 the partnership and its partners. Thus, neither the partnership,
6 the general partner, Robert nor Judith had personal liability for
7 any of the notes.

8 Over the ten-year ownership period, numerous transactions
9 occurred that affected the transfer of, or other modification to
10 the terms of the First, Second, or Wraparound Notes.

11 The present dispute involves the tax treatment of some or
12 all of these modifications, and the taxable obligations of Robert
13 and Judith, and therefore debtor's estate, which arise from the
14 modifications to the First Note, on the one hand, and the
15 modifications to the Second and Wraparound Notes, on the other.

16 While the Stipulation of Facts by the parties filed on
17 September 12, 2006, details the numerous transactions, a summary
18 account of the most pertinent information is as follows.

19 On October 14, 1987, the then-owner of the Second Note and
20 the Wraparound Note transferred the Second Note and Wraparound
21 Note to Judith's attorney, George McGill, for \$240,000 paid by
22 Judith, and the then-owner of all stock in the general partner of
23 the partnership transferred all such stock to McGill for \$10,000
24 paid by Judith.

25 On December 18, 1990, McGill transferred the Second Note and
26 the Wraparound Note to Jerrol L. McLeod in exchange for no money
27 or other property. McLeod, a certified public accountant and
28 real estate investor, was a former colleague of Judith's current

1 certified public accountant.

2 With a downturn in the market and the notes all in default,
3 on December 19, 1992, the partnership and McLeod signed a
4 document entitled "Cancellation and Modification of Promissory
5 Notes" ("Cancellation Agreement"), which provided that McLeod
6 would cancel the Second Note and Wraparound Note on the following
7 conditions: (1) the partnership would assume all obligations of
8 the First Note; (2) Judith would issue a Full Recourse Promissory
9 Note to McLeod for \$50,000; and (3) the partnership would grant
10 McLeod an option for him to purchase the property from the
11 partnership for \$50,000 payable by McLeod's cancellation of the
12 \$50,000 note, plus 85 percent of McLeod's profit on resale of the
13 property. On the same day, the \$50,000 note from Judith to
14 McLeod was issued and the partnership and McLeod signed an option
15 agreement to document the above-contemplated option to purchase.

16 On February 5, 1993, McLeod signed a release of lien with
17 respect to the Second Note and another release of lien with
18 respect to the Wraparound Note.

19 On February 10, 1993, in exchange for approximately \$100,000
20 paid by the partnership, the then-owner of the First Note,
21 Northern Trails Apartments, reduced the amount due on the First
22 Note from approximately \$3.6 million to \$900,000.

23 Also on February 10, 1993, in exchange for \$70,000 and
24 cancellation of the First Note, McLeod conveyed the property to
25 STA Investments, Inc., the new (that day) then-owner of the First
26 Note. The same person was both the president of the managing
27 general partner of Northern Trails Apartments and the president
28 of STA Investments, Inc.

1 McLeod paid the partnership 85 percent of his profit from
2 the resale of the property.

3 For 1992 and 1993, the partnership filed federal income tax
4 returns and Robert and Judith filed joint California income tax
5 returns, reflecting their tax treatment of the specific events
6 that occurred during that particular calendar tax year. Robert
7 and Judith claimed their liabilities exceeded their assets and
8 that they were thus insolvent for 1992 and 1993.

9 Specifically, in its 1992 federal income tax return, the
10 partnership reported discharge of indebtedness income of
11 \$12,395,989 for the reported cancellation in 1992 of the Second
12 Note and Wraparound Note. In their 1992 California income tax
13 return, Robert and Judith reported their 90 percent share of the
14 \$12,395,989 as income and excluded that share from taxable income
15 because they were allegedly insolvent.

16 In its 1993 federal income tax return, the partnership
17 reported discharge of indebtedness income of \$2,626,121 for the
18 reported reduction in 1993 of the amount due on the First Note.
19 In their 1993 California income tax return, Robert and Judith
20 reported their 90 percent share of the \$2,626,121 as income and
21 excluded that share from taxable income because they were
22 allegedly insolvent.

23 On February 22, 1994, Robert Adams filed a chapter 11
24 bankruptcy case, which case was later converted to chapter 7.
25 Appellee Richard M. Kipperman was appointed as chapter 7 trustee.

26 In 1996, the appellant California Franchise Tax Board
27 audited Robert and Judith's 1992 and 1993 income tax returns. As
28 to the 1992 income tax return, the FTB reviewed and analyzed the

1 Cancellation Agreement, and acknowledged the consequences of the
2 transactions and reported income from the cancellation of the
3 Second and Wraparound Notes.

4 For the 1992 audit, the FTB issued a "no change to your tax
5 liability" letter ("no change" letter), concluding that the
6 partnership did not receive discharge of indebtedness income in
7 1992, and thus Robert and Judith had no tax deficiency for that
8 year from the extinguishment of the Second Note and Wraparound
9 Note. The 1992 audit and "no change" letter in effect confirmed
10 only the \$2,302 tax liability originally reported by Robert and
11 Judith in their 1992 tax return.

12 As to the 1993 income tax return, the FTB sought to assess
13 income tax of \$1,361,746 (excluding interest and penalties)
14 against Robert and Judith for that year based upon their 90
15 percent share of the amount realized on the partnership's sale to
16 McLeod of the property while encumbered by the trust deeds
17 securing the First Note, the Second Note, and the Wraparound
18 Note. The FTB filed a Notice of Proposed Assessment on September
19 11, 1998 and filed a Notice of Action on October 18, 2001,
20 indicating this additional tax amount owed.

21 After the trustee and Judith litigated the proposed 1993 tax
22 assessment with the FTB through the state administrative system,
23 the State Board of Equalization upheld the FTB's assessment of
24 the 1993 taxes. The assessment of tax in the principal amount of
25 \$1,361,746 became final on October 11, 2002.

26 On June 24, 2004, the FTB recorded a Notice of Tax Lien in
27 Orange County in the total amount of \$3,004,725.31, which
28

1 included tax plus interest,³ against Judith.

2 Although the FTB had filed proofs of claim in debtor's
3 bankruptcy case for pre-petition tax years other than 1993, the
4 FTB did not file a claim with respect to this assessment.⁴ Thus,
5 on December 31, 2004, pursuant to 11 U.S.C. § 501(c), the
6 trustee, on behalf of the FTB, filed amended Claim No. 50 to take
7 into account the disputed FTB assessment.

8 On December 31, 2004, the trustee filed his objection to the
9 FTB claim. Judith joined in the trustee's objection to the claim
10 on the same day.

11 The parties agreed to a Stipulation of Facts and a trial by
12 declaration of the witnesses (to be available for cross-
13 examination) at a trial set on September 20, 2006. At trial, no
14 cross-examination was requested. The trustee's counsel first
15 asked the court to rule on the application of the duty of
16 consistency and to determine who held the burden of proof before
17 proceeding further. After the FTB conceded it bore the burden of
18 proof,⁵ the court directed the parties to brief additional

19
20 ³\$1,361,746 (principal) + \$1,642,979.31 (interest) =
\$3,004,725.31

21
22 ⁴All parties agree that the statute of limitations for
23 assessing additional tax for 1992, and every prior year, has
expired. Hr'g Tr. 34:9-35:4 (Oct. 25, 2006).

24
25 ⁵Generally, the taxpayer bears the burden of proof with
26 respect to challenging a tax assessment under substantive
27 California tax law. See Raleigh v. Illinois Dep't of Revenue,
28 530 U.S. 15, 17, 20-26 (2000) (burden of proof on a tax claim in
bankruptcy remains where the substantive tax law places it);
Modern Paint & Body Supply, Inc. v. S.B.E., 87 Cal. App. 4th 703,
708 (Ct. App. 2001) (under substantive tax law of California, a
party challenging a tax assessment has the burden of proving that
(continued...)

1 issues, including: (1) whether the FTB made a judicial admission
2 that there was cancellation of debt in 1987; (2) whether the 1992
3 audit and FTB's issuance of a "no change" letter created a type
4 of issue preclusion barring the FTB from claiming that 1992
5 income should be taxed in 1993; and (3) whether the FTB met its
6 burden of proof to show a "step transaction" or "sham
7 transaction" occurred which would uphold the tax assessment.

8 After continued proceedings on October 25, 2006, on the
9 issues, the court sustained the trustee's objection to Claim No.
10 50 for \$1,361,746 and any penalty and interest thereon for 1992
11

12
13 ⁵(...continued)
the assessment is wrong).

14 However, appellees argued that the burden of proof shifted
15 to the FTB when the FTB departed from the facts and reasoning
16 asserted and relied upon when making the assessment, and instead
17 raised new matters. See In re Appeal of Mendelsohn, 1985 Cal.
18 Tax LEXIS 17 (Cal BOE, 1985). Appellees noted that the
19 California Board of Equalization in Mendelsohn expressly adopted
20 the federal tax court's "new matter" rule, citing Achiro v.
21 Comm'r, 77 T.C. 881 (1981). Achiro held that, "If [the FTB's]
22 position on appeal either alters the original deficiency or
23 requires the presentation of different evidence, then a new
24 matter has been introduced and the burden of proving that new
25 position shifts to [the FTB]." Achiro, 77 T.C. 881; Jayne v.
26 Comm'r, 61 T.C. 744 (1974).

27 In the instant case, appellees contended that, while
28 appellees initially bore the burden of proof in challenging the
1993 tax assessment, the burden shifted when the FTB argued in
its trial brief for the first time in the thirteen-year history
of the dispute that the disputed transaction--the cancellation of
the Second and Wraparound Notes--was effective in 1987, and thus,
sham or step transactions occurred from 1987 through 1993.

In fact, the FTB even conceded at the October 25, 2006
hearing that, while the burden of proof in challenging the tax
assessment is on the taxpayer, the FTB bore the burden of
producing evidence to show a sham or step transaction and that it
bore the burden of proof on the duty of consistency. See Hr'g
Tr. 32:17-22 & 33:14-19 (Oct. 25, 2006).

1 and/or 1993.⁶ It further ruled that the FTB judicially admitted
2 that the Second and Wraparound Notes were cancelled in 1987.

3 Alternatively, the court concluded that the FTB was bound by
4 the duty of consistency and principles of judicial estoppel and
5 res judicata, all of which prohibited the FTB from asserting that
6 the Second Note and Wraparound Note were cancelled in any year
7 other than 1992. The court further determined that the FTB had
8 not met its burden on showing a sham or step transaction. The
9 court's rulings were memorialized in findings of fact and
10 conclusions of law entered on February 2, 2007.

11 After the court ruled on the tax liability and forgiveness
12 of debt for the Second Note and Wraparound Note, the court
13 resumed hearing on February 26, 2007, of the tax liability on
14 forgiveness of the First Note in 1993.

15 Specifically, two disputes remained: (1) the taxability of
16 the extinguishment in 1993 of the First Note (which previously
17 had been reduced from approximately \$3.6 million to \$900,000)
18 after the partnership sold the property to McLeod and McLeod
19 resold the property to the holder of the First Note, thereby
20 cancelling the remainder of the First Note and (2) the taxable
21 gain (resulting from the extinguishment in 1987 or 1992 of the
22 Second Note and the Wraparound Note) to Judith in 1993 on the
23 termination of the partnership.

24
25 ⁶As to the issue on burden of proof, the court held that, to
26 the extent that the FTB asserted any theory of liability against
27 the appellees which raised any new issues outside the "four
28 corners of the October 18, 2001 Notice of Action and the
September 11, 1998 Notice of Proposed Assessment," the FTB bore
the burden of proof by admissible evidence. Findings of Fact and
Conclusions of Law at ¶ 22 (Feb. 2, 2007).

1 In an order entered on May 15, 2007, the court ruled on the
2 "remaining disputed items" arising out of trustee's objection to
3 the FTB's claim regarding the tax liability of Robert and Judith
4 for 1993: (1) the income generated by the write-down of the First
5 Note to \$900,000 was properly treated as discharge of
6 indebtedness income; (2) the First Note was properly included as
7 a liability for purposes of determining Robert and Judith's
8 insolvency; and (3) the gain to Judith on termination of the
9 partnership was as provided in the Stipulation of Facts.

10 As a result of the FTB's argument that the actual numbers
11 for tax liability depended on the court's rulings stated above,
12 the May 15, 2007, order directed the parties to calculate the
13 amount of taxes owed for tax year 1993, and allowed the parties
14 to submit figures for the taxes owed for 1990 and 1991.

15 Thereafter, it was made clear at a status conference that
16 the FTB wanted an order fixing the amount of Robert and Judith's
17 liability for 1993, presumably to appeal.

18 On July 2, 2007, the bankruptcy court filed a document
19 entitled "Memorandum" following the parties' efforts to come to
20 an agreement regarding the disputed tax issues. The court
21 concluded that no tax liability was owed for 1993.⁷

22 On July 12, 2007, the FTB appealed the July 2, 2007, order
23 as our No. SC-07-1283. The trustee moved to dismiss the appeal
24 as untimely, arguing that the FTB should have appealed the May
25

26
27 ⁷Not pertinent to the present dispute, the court also
28 concluded that the 1990 and 1991 tax liability had been
determined long ago and was not part of the present contested
matter.

1 15, 2007, order on grounds that it was the final order because
2 the tax calculations to be determined were merely ministerial.
3 On October 2, 2007, the Panel issued an order denying trustee's
4 motion to dismiss. The Panel further determined that the May 15,
5 2007, order was interlocutory, and the July 2, 2007, order
6 entitled "Memorandum," was a final order.⁸

7
8 JURISDICTION

9 The bankruptcy court had jurisdiction via 28 U.S.C. § 1334.
10 We have jurisdiction under 28 U.S.C. § 158(a)(1).

11
12 ISSUES

13 (1) Whether the FTB's appeal of the July 2, 2007, order
14 entitled "Memorandum" was correct and its subsequent appeal of
15 the May 15, 2007, order was timely.

16 (2) Whether the court erred in ruling that Robert and Judith
17 had no taxable gain and no taxable discharge of indebtedness for
18 1993 from the cancellation of the Second and Wraparound Notes.

19 (3) Whether the court erred in ruling that the FTB's 1992
20 "no change" letter (concluding no tax deficiency in 1992 by

21
22 ⁸On October 11, 2007, the FTB filed a new notice of appeal
23 from the May 15, 2007, order and requested consolidation with BAP
24 No. SC-07-1283. The appeal from the May 15, 2007, order was
25 assigned BAP No. SC-07-1394. The Panel subsequently filed a
26 Notice of Deficient Appeal and Impending Dismissal ("NOD"),
27 indicating that BAP No. SC-07-1394 appeared untimely and required
28 the FTB to file a response. On November 5, 2007, the Panel
ordered the NOD vacated. It further ordered that the appeals
were now consolidated and any further papers were to be filed
under BAP No. SC-07-1283. The Panel allowed supplemental
briefing to address any additional issues related to the May 15,
2007, order to be filed by November 19, 2007.

1 Robert and Judith for the extinguishment of the Second and
2 Wraparound Notes) estopped the FTB from now assessing taxes in
3 1993 for extinguishment of the two notes that occurred upon sale
4 of the property that year.

5 (4) Whether the court erred in ruling that no additional tax
6 was due for 1993 relating to the reduction of the First Note.

7
8 STANDARDARDS OF REVIEW

9 Whether an order is a final order is a question of law
10 reviewed de novo. Silver Sage Partners, Ltd. v. City of Desert
11 Hot Springs (In re City of Desert Hot Springs), 339 F.3d 782, 787
12 (9th Cir. 2003), cert. denied, 540 U.S. 1110 (2004).

13 We review findings of fact for clear error and issues of law
14 de novo. Hoopai v. Countrywide Home Loans, Inc. (In re Hoopai),
15 369 B.R. 506, 509 (9th Cir. BAP 2007). Clear error exists when,
16 on the entire evidence, the reviewing court is left with the
17 definite and firm conviction that a mistake was committed. Id.

18 The trial court's application of judicial estoppel to the
19 facts of a case is reviewed for abuse of discretion. Hamilton v.
20 State Farm, 270 F.3d 778, 782 (9th Cir. 2001).

21 We review rulings regarding the availability of rules of res
22 judicata, including claim and issue preclusion, de novo as mixed
23 questions of law and fact. Khaligh v. Hadaegh (In re Khaligh),
24 338 B.R. 817, 823 (9th Cir. BAP 2006). However, once it is
25 determined that preclusion doctrines are available to be applied,
26 the actual decision to apply them is left to the trial court's
27 discretion. Id.

1 A trial court necessarily abuses its discretion if it bases
2 its decision on an erroneous view of the law or clearly erroneous
3 factual findings. Cooter & Gell v. Hartmarx Corp., 496 U.S. 384,
4 405 (1990). Otherwise, to reverse for an abuse of discretion, we
5 must have a definite and firm conviction that the court committed
6 a clear error of judgment in the conclusion it reached. S.E.C.
7 v. Coldicutt, 258 F.3d 939, 941 (9th Cir. 2001); Hansen v. Moore
8 (In re Hansen), 368 B.R. 868, 874-75 (9th Cir. BAP 2007).

9
10 DISCUSSION

11 Before delving into the substance of this appeal regarding
12 tax issues, we address the preliminary matter of the appellees'
13 position that the FTB's appeal of the July 2, 2007, order
14 entitled "Memorandum" was incorrect and the FTB's appeal of the
15 May 15, 2007, order was untimely.

16
17 I

18 In denying the appellees' motion to dismiss the FTB's appeal
19 of the July 2, 2007, order, the Panel previously ruled that the
20 May 15, 2007, order was interlocutory and the July 2, 2007, order
21 was final. When the FTB filed a notice of appeal of the May 15,
22 2007, order, the Panel ultimately responded by ruling that the
23 FTB's appeal of the July 2, 2007, order and its subsequent appeal
24 of the May 15, 2007, order were consolidated. It instructed that
25 the parties could provide supplemental briefs regarding any
26 additional issues concerning the May 15, 2007, order.

27 Appellees contend that the FTB's filing of the notice of
28 appeal from the May 15, 2007, order on October 11, 2007 was

1 untimely because the May 15, 2007, order was a final decision
2 that satisfied the separate judgment rule of Fed. R. Civ. P. 9021
3 to start the 10-day window of time to appeal. See Fed. R. of
4 Civ. P. 58 incorporated by Fed. R. Bankr. P. 9021.⁹

5 In contrast, the FTB argues that, despite its filing a
6 notice of appeal of the July 2, order, it also filed a notice of
7 appeal of the May 15, 2007, order solely as a protective measure
8 in the event that the Court of Appeals for the Ninth Circuit
9 decides, contrary to the Panel, that the May 15, 2007, order was
10 final. The FTB also contends that, because the May 15, 2007,
11 order was a 15-page opinion concluding with further directions
12 and a suggestion to the parties without a separately documented
13 judgment, the order violated the separate judgment requirement of
14 Rule 58, thereby triggering a 160-day deadline to appeal. Fed.
15 R. Civ. P. 58(b)(2)(B) incorporated by Fed. R. Bankr. P. 9021.¹⁰
16 The FTB filed its notice of appeal of the May 15, 2007, order
17 within the 160-day deadline.

18 Under Rule 58, which requires that orders disposing of
19 contested matters be set forth in separate documents, "separate
20 document" means one separate from an opinion or memorandum.
21 United States v. Schimmels (In re Schimmels), 85 F.3d 416, 420

23 ⁹Federal Rule of Civil Procedure 58(a) provides, in
24 pertinent part, "Every judgment . . . must be set forth on a
separate document."

25 ¹⁰Federal Rule of Civil Procedure 58(b)(2)(B) provides, in
26 pertinent part: "Judgment is entered for purposes of these rules
27 if Rule 58(a)(1) requires a separate document . . . and . . .
when 150 days have run from entry in the civil docket."

28 The 150-day time period plus the 10-day time period in which
to file a notice of appeal equals the 160-day deadline.

1 (9th Cir. 1996); Horton v. Rehbein (In re Rehbein), 60 B.R. 436,
2 439 (9th Cir. BAP 1986). While the separate judgment rule does
3 not always require the filing of two separate documents, the
4 separate judgment rule requires that the court enter a judgment
5 or an order; it does not require that the court enter an initial
6 memorandum or opinion. Schimmels, 85 F.3d at 421.

7 Since the May 15, 2007, order was not separate from the
8 opinion, containing findings of fact and conclusions of law, the
9 May 15, 2007, order did not comply with the separate judgment
10 rule, thereby triggering Rule 58(b)(2)(B). Therefore the FTB had
11 160 days in which to file its appeal. Thus, the FTB appeal filed
12 on October 11, 2007, was timely.

13 Alternatively, because we previously ruled that the May 15,
14 2007, order, was interlocutory, the May 15, 2007, order merged
15 into the July 2, 2007, final order and it was unnecessary for the
16 FTB to appeal the May 15, 2007, order. See Baldwin v. Redwood
17 City, 540 F.2d 1360, 1364 (9th Cir. 1976) (“[A]n interlocutory
18 appeal is permissive, not mandatory. When an appeal is not
19 taken, the interlocutory order merges in the final judgment and
20 may be challenged in an appeal from that judgment.”).

21 The FTB’s appeal of the July 2, 2007, order, in spite of its
22 “Memorandum” title, was timely. Furthermore, the conclusions of
23 law set forth in the May 15, 2007, order were merged into the
24 July 2, 2007, final order.

25 In short, we treat the FTB’s appeal of the July 2, 2007,
26 order and its appeal of the May 15, 2007, order as consolidated.

1 II

2 The first issue regarding Robert and Judith's tax liability
3 is whether the court erred in ruling that they had no taxable
4 gain and no taxable discharge of indebtedness income for 1993
5 from the cancellation of the Second and Wraparound Notes.¹¹ In

6 _____
7 ¹¹As outlined in the FTB's opening brief, these are the tax
8 laws related to the parties' arguments.

9 [G]ross income means all income from whatever source
10 derived, including (but not limited to) the following
11 items:

- 12
- 13 (3) Gains derived from dealings in property;
- 14
- 15 (12) Income from discharge of indebtedness;
- 16

17 26 11 U.S.C. § 61(a).

18 Section 17071 of the California Revenue and Taxation Code
19 provides that gross income shall be defined by § 62 of the
20 Internal Revenue Code. Cal. Stats. 1984, ch. 938, § 10, pp.
21 3201-02. Furthermore, it is proper to rely on federal precedent
22 to interpret the California statute. Spurgeon v. Franchise Tax
23 Board, 160 Cal. App. 3d 524, 528 (Ct. App. 1984).

24 The gain from sale or other disposition of property is the
25 excess of the amount realized over the adjusted basis. 26 U.S.C.
26 § 1001(a). The amount realized on a sale or other disposition of
27 property includes the amount of non-recourse debt encumbering the
28 property. Comm'r v. Tufts, 461 U.S. 300, 304-17 (1983); Crane v.
Comm'r, 331 U.S. 1, 12-14 (1947).

Pursuant to 26 U.S.C. § 61(a)(12), a debtor may realize
income from the discharge of indebtedness where his debt is
cancelled, forgiven, or otherwise discharged for less than the
full amount of the debt. 2926 Briarpark, Ltd. v. Comm'r, 163
F.3d 313, 318 (5th Cir. 1999). Where debt forgiveness and
property disposition are closely intertwined, there is a single
transaction governed by 26 U.S.C. § 61(a)(3) (gains from dealings
in property), not 26 U.S.C. § 61(a)(12) (income from discharge of
indebtedness). Id. at 317-19.

Gross income does not include discharge of indebtedness if
the discharge of indebtedness occurs when the taxpayer is

(continued...)

1 making its ruling, the court held that the rule of consistency
2 estopped the FTB from arguing that the Second and Wraparound
3 Notes were cancelled in any year other than 1987, and further
4 determined that the two notes were cancelled in 1992. In
5 addition, the court concluded that the modifications of the
6 Second and Wraparound Notes were not a sham, step or single
7 transaction in 1993.

8 We review each of the court's bases of decision in turn.
9

10 A

11 The appellees argue that the Cancellation Agreement in 1992
12 effectively cancelled the Second and Wraparound Notes. The FTB
13 counters that the two notes were cancelled in 1987 when Judith
14 purchased the two notes for her attorney McGill, and Judith did
15 not report the taxable discharge of indebtedness income in 1987.

16 The FTB further argues that the duty of consistency estops
17 the appellees from asserting either a 1987 cancellation¹² or a
18 1992 cancellation (which the FTB contends was a sham transaction)
19 of the two notes and that the two notes effectively survived to
20 1993 when they were finally extinguished that year upon sale of
21 the property they encumbered (thus, subject to taxation in 1993).
22

23
24 ¹¹(...continued)
25 insolvent. 26 U.S.C. § 108(a)(1)(B). Insolvent means excess of
26 liabilities over the fair market value of assets. 26 U.S.C.
§ 108(d)(3). There is no insolvency exception for income from
gain derived from dealings in property per 26 U.S.C. § 61(a)(3).

27 ¹²The six-year statute of limitations under Cal. Rev. & Tax.
28 Code § 19057 for tax year 1987 has lapsed. Thus, the FTB cannot
assert a claim for any change to the tax liability for 1987.

1 After reviewing the evidence submitted and the parties'
2 arguments, the court concluded that the FTB made a judicial
3 admission that there was a cancellation of the Second and
4 Wraparound Notes in 1987.

5 Although we agree with the court's conclusion, we clarify
6 that the FTB's putative admission that the two notes were
7 cancelled in 1987 was, technically speaking, an evidentiary
8 admission,¹³ not a judicial admission.¹⁴ In this instance,
9 however, it is a distinction without a difference because, even
10 as an evidentiary admission, the court correctly exercised its
11 discretion to accept the statement, which we do not see as error.

12 In addition, the court turned the FTB's rule of consistency
13 argument back on the FTB, holding that the rule of consistency
14 prohibited the FTB from taking a position contrary to its
15 admission that the two notes were cancelled in 1987, the statute
16 of limitations having run for 1987 taxes.

17 The duty of consistency prevents a taxpayer who has already
18 had the advantage of a past misrepresentation (in a year now
19

20 ¹³Evidentiary admissions, unlike judicial admissions, are
21 mere evidence, are not conclusive, and may be contradicted by
22 other evidence. In re Applin, 108 B.R. 253, 259 (Bankr. E.D.
Cal. 1989).

23 ¹⁴Judicial admissions are statements so far beyond dispute
24 that evidence is not required. Applin, 108 B.R. at 258.
25 However, under modern rules, lawyers and judges tend to use the
26 term "judicial admission" to encompass such technically distinct
27 items as pleadings, statements in pretrial orders, and responses
28 to requests for admission in addition to formal stipulations.
See, e.g., Mansfield, Lawyers' Admissions, 12 Litigation, Fall
1985, at 39, 40. With judicial admissions, some degree of
formality is entailed. Applin, 108 B.R. at 258. The court has
discretion to accept or reject the judicial admission. Id.

1 closed to government review) from changing his position and, by
2 claiming he should have paid more tax before, avoiding the
3 present tax. Eagan v. United States, 80 F.3d 13, 16-17 (1st Cir.
4 1996); Estate of Posner, 87 T.C.M. (CCH) 1288 (2004).

5 The court held that the appellees had not violated the rule
6 of consistency, as the FTB contends, because neither the trustee
7 nor Judith ever took the position that there was a cancellation
8 of the Second or Wraparound Notes in 1987. The court further
9 concluded that Robert and Judith were not bound by the duty of
10 consistency as to their mistake of law in believing that McGill's
11 acquisition was not taxable discharge of indebtedness income in
12 1987. See Posner, 87 T.C.M. (CCH) 1288. In addition, it ruled
13 that the appellees met their burden of proof in showing that the
14 Cancellation Agreement was effective in 1992.

15 We agree with the trial court. The court did not abuse its
16 discretion in holding the FTB to its admission that the Second
17 and Wraparound Notes were cancelled in 1987, and thereupon ruling
18 that the rule of consistency prohibited the FTB from taking a
19 contrary position. In admitting that the two notes were
20 cancelled in 1987, the FTB cannot now argue that the
21 extinguishment of those notes occurred in 1993 upon sale of the
22 property, and, thus, cannot now assert a tax deficiency for 1993.

23 Moreover, perceiving no clear error in the findings of fact,
24 we hold that the trial court did not err in ruling that appellees
25 met their burden of proof in showing that the Cancellation
26 Agreement was effective in 1992.

1
2 In support of its contention that Robert and Judith incurred
3 tax liability for year 1993, the FTB further attempts to
4 discredit the appellees' position that the Second and Wraparound
5 Notes were cancelled in 1992 by asserting that the purported 1992
6 cancellation was either a sham,¹⁵ step or single¹⁶ transaction.
7 The FTB argues that the two notes were essentially transferred
8 for free to McLeod because Judith's previous purchase of the two
9 notes for her attorney McGill (who had a fiduciary duty as
10 Judith's agent) was a sham.

11 After listening to testimony at trial and testimony
12 submitted to the court to show that a substantial business
13 purpose existed for the multiple modifications executed by the
14 numerous entities, the court held that the FTB did not meet its
15 burden to prove a sham, step or single transaction and that a
16 substantial business purpose existed to the various agreements.¹⁷

17
18 ¹⁵Sham transactions are not recognized for tax purposes.
19 Freytag v. Comm'r, 904 F.2d 1011, 1015 (5th Cir. 1990), aff'd,
501 U.S. 868 (1991).

20 ¹⁶The step transaction doctrine collapses formally distinct
21 steps in an integrated transaction in order to assess federal tax
22 liability on the basis of a realistic view of the entire
23 transaction. Brown v. United States, 329 F.3d 664, 671 (9th Cir.
24 2003), cert. denied, 540 U.S. 878 (2003). The doctrine treats
25 the steps in a series of formally separate but related
transactions involving the transfer of property as a single
transaction, if all the steps are substantially linked. Green v.
United States, 13 F.3d 577, 583 (2d Cir. 1994).

26 ¹⁷At trial, the court concluded:

27 But I'm also not persuaded that there is a
28 preponderance of evidence that in fact there was a

(continued...)

1 As the trial court is the trier of fact on the entire evidence,
2 we are not definitely and firmly convinced that the court was
3 clearly erroneous in this regard.

4 Accordingly, we will not disturb the trial court's
5 conclusion that Robert and Judith had no taxable gain and no
6 taxable discharge of indebtedness income for 1993 from the
7 cancellation of the Second and Wraparound Notes.

8
9 III

10 Next, the FTB contends that the 1992 "no change" letter it
11 issued (concluding that the partnership did not receive a
12 discharge of indebtedness income in 1992, and thus, Robert and
13 Judith had no tax deficiency in that year from the cancellation
14 of the Second and Wraparound Notes) did not estop the FTB from
15 assessing a tax deficiency in 1993 when the two notes were
16 extinguished that year upon sale of the property they encumbered.

17 The court based its ruling on principles of res judicata
18 (claim and issue preclusion), judicial estoppel, and the rule of
19

20
21 ¹⁷(...continued)

22 sham. Step transaction, [sic] I'm just -- I'm just not
23 believing that when you collapse the events of '87, the
24 events for that matter preceded it, but '87 in terms of
25 buying the notes, the transfer of the notes in '90, the
26 agreement in '92, that those are all part and parcel of
27 some agreed-upon single transaction. . . . Given those
28 circumstances, I don't see a factual basis in the
record before me that would support the notion that
this was a step transaction that would somehow get us
to 1993 again.

Hr'g Tr. 46:10-25 (Oct. 25, 2006).

1 consistency. On those bases, it estopped the FTB from taking a
2 position inconsistent with the FTB's 1992 "no change" letter.

3 While the court correctly applied the doctrine of judicial
4 estoppel and the rule of consistency to the facts, it is arguable
5 whether res judicata principles applied in this case. We need
6 not explore the matter in detail, however, because judicial
7 estoppel and the rule of consistency are adequate independent
8 bases for the court's conclusion. See Alary Corp. v. Sims (In re
9 Associated Vintage Group), 283 B.R. 549, 565 (9th Cir. BAP 2002).

10 The principles of res judicata (whether claim preclusion or
11 issue preclusion)¹⁸ are predicated on the existence of a valid
12 final judgment.¹⁹

13 The "no change" letter issued by the FTB is not the same as
14 a final judgment issued by a court. Thus, principles of res
15 judicata probably do not apply to the issue of whether the FTB's
16 conclusion in its 1992 audit barred it from assessing a tax
17

18
19 ¹⁸Modernly, the generic term "res judicata" refers to
20 concepts addressed in the Restatement(Second) of Judgments
21 regarding preclusive effects of former litigation. Associated
22 Vintage Group, 283 B.R. at 555. These subsume the conceptually
distinct categories of claim and issue preclusion. Paine v.
Griffin (In re Paine), 283 B.R. 33, 38 (9th Cir. BAP 2002).

23 ¹⁹Claim preclusion generally requires that there be: (1)
24 parties either identical or in privity; (2) a judgment rendered
25 by a court of competent jurisdiction; (3) a prior action
26 concluded to final judgment on the merits; and (4) the same claim
27 or cause of action involved in both actions. Paine, 283 B.R. at
28 39.

Issue preclusion generally requires that there be: (1) the
27 same issue; (2) actually litigated and determined; (3) by a valid
28 and final judgment; (4) as to which the determination is
essential to the judgment. Id.

1 deficiency in 1993.²⁰

2 As noted, however, even though res judicata principles may
3 not apply to this situation, the court did not err in its
4 application of the equitable doctrines of judicial estoppel and
5 the rule of consistency.²¹

6 Judicial estoppel precludes a party from gaining an
7 advantage by asserting one position, and then later seeking an
8 advantage by taking a clearly inconsistent position. Hamilton,
9 270 F.3d at 782; Associated Vintage Group, 283 B.R. at 566. As
10 noted, the rule of consistency (which is in the nature of an
11

12 ²⁰Incidentally, the State Board of Equalization's October
13 11, 2002 decision that upheld the FTB's assessment of the 1993
14 taxes might constitute a final judgment. See Restatement
15 (Second) of Judgments § 83 (1982). In some circumstances, an
16 adjudicative determination of a claim or issue by an
administrative tribunal does not preclude relitigation in another
tribunal. Id. § 83(3) & (4).

17 In fact, at the September 20, 2006 hearing, the FTB's
18 counsel articulated an understanding that decisions of the State
19 Board of Equalization are tried de novo by reviewing courts and
20 that neither the State Board of Equalization's decision nor the
21 audit constituted a final judgment. See Hr'g Tr. 33:23-34:5
(Sept. 20, 2006). The FTB's counsel then conceded that it was
22 not going to argue whether the finality of the Board's decision
23 barred further review. Id. 34:13-24.

24 Regardless, because the FTB did not contest the trustee's
25 objection to its 1993 tax assessment as already litigated and
26 determined, we do not consider it here. See Golden v. Chicago
27 Title Ins. Co. (In re Choo), 273 B.R. 608, 613 (9th Cir. BAP
28 2002) (issues not raised at the trial court are not considered
for the first time on appeal and arguments not specifically and
distinctly made in an appellant's opening brief are waived).

26 ²¹The difference between estoppel and principles of res
27 judicata is that estoppel is based on conduct of a party in the
28 course of litigation, while claim and issue preclusion follow
from the fact of the judgment without reference to anyone's
conduct. Associated Vintage Group, 283 B.R. at 565.

1 estoppel) also estops a party from gaining an advantage by taking
2 inconsistent positions. See Eagan v. United States, 80 F.3d at
3 16-17; Posner, 87 T.C.M. (CCH) 1288.

4 Furthermore, independent of unfair advantage from
5 inconsistent positions, judicial estoppel may be invoked: out of
6 "general consideration of the orderly administration of justice
7 and regard for the dignity of judicial proceedings;" to "protect
8 against a litigant playing fast and loose with the courts;" and
9 "to protect the integrity of the bankruptcy process." Hamilton,
10 270 F.3d at 782 & 785; Associated Vintage Group, 283 B.R. at 566.

11 Judicial estoppel requires that the court's reliance on the
12 inconsistent position would result in an unfair advantage or
13 unfair detriment without an estoppel.²² Associated Vintage
14 Group, 283 B.R. at 566.

15 It is to the trial court's discretion as to the appropriate
16 circumstance to apply judicial estoppel or a quasi-estoppel under
17 the rule of consistency. Although res judicata principles were
18 not applicable, the court nevertheless did not abuse its
19 discretion in concluding that judicial estoppel and the rule of
20 consistency estopped the FTB from assessing a tax deficiency in
21 1993 for the alleged cancellation of the Second and Wraparound
22 Notes in 1993 when it had previously concluded that Robert and
23 Judith did not incur a tax deficiency in 1992 for the
24 cancellation of the two notes in that year. We are not

26 ²²We note that judicial estoppel is distinguishable from
27 equitable estoppel in that a party's reliance on an inconsistent
28 position results in an unfair advantage or unfair detriment.
Associated Vintage Group, 283 B.R. at 567 (emphasis added).

1 definitely and firmly convinced that the bankruptcy court
2 committed a clear error in judgment in its conclusion. See
3 Coldicutt, 258 F.3d at 941; Hansen, 368 B.R. at 874-75. Thus, we
4 perceive no error.

5
6 IV

7 After a separate hearing occurred on the remaining issues in
8 dispute between the parties, the court held that the First Note
9 (reduced from approximately \$3.6 million to \$900,000), the write-
10 down of which gave rise to discharge of indebtedness income,
11 should be accounted for in the 26 U.S.C. § 108(a)(1)(B)²³
12 insolvency calculation, by which discharge of indebtedness income
13 was not included in 26 U.S.C. § 61(a)(12) gross income because
14 Robert and Judith were insolvent.²⁴

15 The appellees contend that discharge of indebtedness income
16 resulting from the reduction of the First Note, reported in their
17 1993 tax return, was not included in gross income as non-taxable
18 pursuant to 26 U.S.C. § 108(a)(1)(B) because they were insolvent.

19 On the other hand, the FTB argues that the cancellation of
20 indebtedness income is taxable and Robert and Judith cannot take
21 advantage of the insolvency exception to the general rule of
22

23 ²³Section 108(a)(1)(B) provides that, "Gross income does not
24 include any amount which (but for this subsection) would be
25 includible in gross income by reason of discharge (in whole or in
part) of indebtedness of the taxpayer if . . . the discharge
occurs when the taxpayer is insolvent."

26 ²⁴"Insolvency" for purposes of cancellation of indebtedness
27 means the excess of liabilities over the fair market value of
28 assets, as determined immediately before the discharge. 26
U.S.C. § 108(d)(3).

1 inclusion of discharge of indebtedness income in gross income
2 because they were not insolvent in 1993.

3 The dispute as to Robert and Judith's insolvency is a
4 question of fact, in which we hold that the bankruptcy court was
5 not clearly erroneous in its conclusion. The court determined:

6 The FTB appears to have taken the position that the
7 Adams can receive [discharge of indebtedness income]
8 from the write-down of the First Note, but cannot
9 include the First Note in their insolvency calculation.
10 Not surprisingly, the FTB provides no authority to
11 support their position. The Court finds the argument
12 to be internally inconsistent and the result
13 nonsensical.

14 Order on Tr.'s Objection to Claim No. 50 (Remaining Disputed
15 Items) 11:7-13 (May 15, 2008).

16 In addition, while the FTB cites Merkel v. Comm'r, 192 F.3d
17 844, 850 (9th Cir. 1999) in support of its argument, we agree
18 with the appellees that Merkel is distinguishable in that the
19 liability, which was excluded from the insolvency calculation was
20 not the very obligation which generated discharge of indebtedness
21 income, unlike the present case.

22 We also agree that Revenue Ruling 92-53, 1992-CB 48, cited
23 by the appellees for the proposition that non-recourse debt is
24 included in the insolvency calculation to determine if discharge
25 of indebtedness income is taxable, governs in this case.

26 Thus, we hold that the court did not err in ruling that
27 Robert and Judith had no additional tax for 1993 relating to the
28 reduction of the First Note.

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1 CONCLUSION

2 Having determined our jurisdiction to review the present
3 appeal of the July 2, 2007, order, as consolidated with the
4 subsequent appeal of the May 15, 2007, order, we AFFIRM the trial
5 court's decisions.

6 Specifically, the court did not err in its rulings as
7 follows:

8 (1) that Robert and Judith had no taxable gain and no
9 taxable discharge of indebtedness income for 1993 from the
10 cancellation of the Second and Wraparound Notes;

11 (2) that the FTB was estopped from taking a position
12 contrary to its 1992 "no change" letter; and

13 (3) that Robert and Judith had no additional tax for 1993
14 relating to the reduction of the First Note.

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