NOT FOR PUBLICATION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.

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[*]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.

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

FACTS

Debtor Robert Adams and his former spouse, appellee Judith Adams, own an interest in Trails partnership,[1] a limited partnership that had as its sole asset an apartment complex in Dallas, Texas. The partnership purchased the property in October 1982 and sold it on February 10, 1993.[2]

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

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[1]Judith was a limited partner owning a 90 percent interest in the partnership, which was formed under Texas law on October 28, 1982. During 1992 and 1993, Pacific/Trails Associates, Inc., 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.

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

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

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

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

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

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

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

certified public accountant.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

included tax plus interest,[3] against Judith.

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

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

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

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[3]$1,361,746 (principal) + $1,642,979.31 (interest) = $3,004,725.31

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

[5]Generally, the taxpayer bears the burden of proof with respect to challenging a tax assessment under substantive California tax law. See Raleigh v. Illinois Dep't of Revenue, 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...)

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

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

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[5](...continued)
the assessment is wrong).

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

In the instant case, appellees contended that, while 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).

and/or 1993.[6] It further ruled that the FTB judicially admitted that the Second and Wraparound Notes were cancelled in 1987.

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

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

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

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[6]As to the issue on burden of proof, the court held that, to the extent that the FTB asserted any theory of liability against the appellees which raised any new issues outside the "four 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).

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

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

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

On July 2, 2007, the bankruptcy court filed a document entitled "Memorandum" following the parties' efforts to come to an agreement regarding the disputed tax issues. The court concluded that no tax liability was owed for 1993.[7]

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

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

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

JURISDICTION

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

ISSUES

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

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

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

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[8]On October 11, 2007, the FTB filed a new notice of appeal from the May 15, 2007, order and requested consolidation with BAP No. SC-07-1283. The appeal from the May 15, 2007, order was assigned BAP No. SC-07-1394. The Panel subsequently filed a Notice of Deficient Appeal and Impending Dismissal ("NOD"), indicating that BAP No. SC-07-1394 appeared untimely and required 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.

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

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

STANDARDS OF REVIEW

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

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

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

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

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

DISCUSSION

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

I

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

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

untimely because the May 15, 2007, order was a final decision that satisfied the separate judgment rule of Fed. R. Civ. P. 9021 to start the 10-day window of time to appeal. See Fed. R. of Civ. P. 58 incorporated by Fed. R. Bankr. P. 9021.[9]

In contrast, the FTB argues that, despite its filing a notice of appeal of the July 2, order, it also filed a notice of appeal of the May 15, 2007, order solely as a protective measure in the event that the Court of Appeals for the Ninth Circuit decides, contrary to the Panel, that the May 15, 2007, order was final. The FTB also contends that, because the May 15, 2007, order was a 15-page opinion concluding with further directions and a suggestion to the parties without a separately documented judgment, the order violated the separate judgment requirement of Rule 58, thereby triggering a 160-day deadline to appeal. Fed. R. Civ. P. 58(b)(2)(B) incorporated by Fed. R. Bankr. P. 9021.[10] The FTB filed its notice of appeal of the May 15, 2007, order within the 160-day deadline.

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

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

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

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

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

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

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

The FTB's appeal of the July 2, 2007, order, in spite of its "Memorandum" title, was timely. Furthermore, the conclusions of law set forth in the May 15, 2007, order were merged into the July 2, 2007, final order.

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

II

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

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[11]As outlined in the FTB's opening brief, these are the tax laws related to the parties' arguments.

> [G]ross income means all income from whatever source derived, including (but not limited to) the following items:
> . . .
> (3) Gains derived from dealings in property;
> . . .
> (12) Income from discharge of indebtedness;
> . . . .

26 11 U.S.C. § 61(a).

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

The gain from sale or other disposition of property is the excess of the amount realized over the adjusted basis. 26 U.S.C. § 1001(a). The amount realized on a sale or other disposition of property includes the amount of non-recourse debt encumbering the 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

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

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

A

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

The FTB further argues that the duty of consistency estops the appellees from asserting either a 1987 cancellation[12] or a 1992 cancellation (which the FTB contends was a sham transaction) of the two notes and that the two notes effectively survived to 1993 when they were finally extinguished that year upon sale of the property they encumbered (thus, subject to taxation in 1993).

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[11](...continued)
insolvent. 26 U.S.C. § 108(a)(1)(B). Insolvent means excess of 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).

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

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

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

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

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

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

[14]Judicial admissions are statements so far beyond dispute that evidence is not required. Applin, 108 B.R. at 258. However, under modern rules, lawyers and judges tend to use the term "judicial admission" to encompass such technically distinct items as pleadings, statements in pretrial orders, and responses 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.

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

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

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

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

B

In support of its contention that Robert and Judith incurred tax liability for year 1993, the FTB further attempts to discredit the appellees' position that the Second and Wraparound Notes were cancelled in 1992 by asserting that the purported 1992 cancellation was either a sham,[15] step or single[16] transaction. The FTB argues that the two notes were essentially transferred for free to McLeod because Judith's previous purchase of the two notes for her attorney McGill (who had a fiduciary duty as Judith's agent) was a sham.

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

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

[16]The step transaction doctrine collapses formally distinct steps in an integrated transaction in order to assess federal tax liability on the basis of a realistic view of the entire transaction. Brown v. United States, 329 F.3d 664, 671 (9th Cir. 2003), cert. denied, 540 U.S. 878 (2003). The doctrine treats 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).

[17]At trial, the court concluded:

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

(continued...)

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

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

III

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

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

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[17](...continued)

> sham. Step transaction, [sic] I'm just -- I'm just not believing that when you collapse the events of '87, the events for that matter preceded it, but '87 in terms of buying the notes, the transfer of the notes in '90, the agreement in '92, that those are all part and parcel of some agreed-upon single transaction. . . . Given those 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).

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

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

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

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

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[18]Modernly, the generic term "res judicata" refers to concepts addressed in the Restatement(Second) of Judgments regarding preclusive effects of former litigation. Associated 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).

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

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

deficiency in 1993.[20]

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

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

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

In fact, at the September 20, 2006 hearing, the FTB's counsel articulated an understanding that decisions of the State Board of Equalization are tried de novo by reviewing courts and that neither the State Board of Equalization's decision nor the 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 not going to argue whether the finality of the Board's decision barred further review. Id. 34:13-24.

Regardless, because the FTB did not contest the trustee's objection to its 1993 tax assessment as already litigated and determined, we do not consider it here. See Golden v. Chicago Title Ins. Co. (In re Choo), 273 B.R. 608, 613 (9th Cir. BAP 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).

[21]The difference between estoppel and principles of res judicata is that estoppel is based on conduct of a party in the 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.

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

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

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

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

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

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

IV

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

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

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

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[23]Section 108(a)(1)(B) provides that, "Gross income does not include any amount which (but for this subsection) would be 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."

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

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

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

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

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

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

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

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

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CONCLUSION

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

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

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

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

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