

UNITED STATES BANKRUPTCY COURT EASTERN
DISTRICT OF CALIFORNIA

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA

In re:

JAMES RICHARD JORGENSEN
and LAURA MAE JORGENSEN,

Debtors.

DONALD G. ALUISI
and KAREN ALUISI,

Plaintiffs,

v.

JAMES RICHARD JORGENSEN,
Defendant.

Case No. 18-14586-A-13

Adv. No. 19-01026-A

MEMORANDUM

NEA-3

Argued and submitted on November 12, 2019

at Fresno, California

Honorable Fredrick E. Clement, Bankruptcy Judge Presiding

Appearances: Kurt F. Vote, Wanger Jones Helsley PC for
plaintiffs Donald G. Aluisi and Karen
Aluisi; Nicholas E. Aniotzbehene, Yarra
Law Group for defendant James Richard
Jorgensen

1 Malpractice becomes fraud when an accountant knowingly conceals
2 his own error. Former clients sued their accountant for two counts of
3 fraud. Count I alleges that the accountant understated the clients'
4 tax basis on their state income tax returns. It also hints discovery
5 from his reduction of the correct federal income tax basis to the
6 incorrect state income tax basis on subsequent tax returns. Count II
7 alleges the accountant gave faulty § 1031 Exchange advice and suggests
8 knowledge from his involvement in 20-40 § 1031 Exchanges over a 50-
9 year career. Have his former clients pled facts showing the
10 accountant's actual knowledge as to each error?

11 **I. FACTS**

12 Defendant James Richard Jorgensen ("Jorgensen") has been a
13 Certified Public Accountant for 50 years. Starting in the late 1980s
14 and continuing until 2015, Jorgensen rendered services to Donald G.
15 Aluisi and Karen Aluisi ("Aluisis"), who were farmers,
16 businesspersons, and commercial landholders. Jorgensen prepared the
17 Aluisis' returns and advised them on financial matters. Among the
18 matters on which the Aluisis consulted Jorgensen were tax-deferred
19 transactions. At issue are two instances of excess tax liability
20 resulting from Jorgensen's services to the Aluisis.

21 **A. The Trading Post Depreciation**

22 In 2000, Aluisis purchased "The Trading Post," a commercial
23 property, from Donald G. Aluisi's father in a tax-deferred exchange.
24 Jorgensen represented both the elder Aluisi and the plaintiff Aluisis
25 in that transaction.

26 When Jorgensen prepared the plaintiff Aluisis' 2000 federal and
27 state income tax returns, he made an error on the state income tax
28 return. As the Aluisis stated the problem:

1 In early 2001, [Jorgensen] prepared [Aluisis'] 2000
2 tax returns, which included the 1031 Exchange for The
3 Trading Post. What occurred next was not discovered
4 until many years later - 2017 - by [Aluisis'] new
5 Certified Public Accountant. **In the 2000 tax returns
6 both Federal and State bases were correct and
7 consistent (the amount of \$3,695,335) on the
8 disclosure page, however on the depreciation page, the
9 State tax basis, which should have remained consistent
10 with the Federal tax basis[,] was lowered to
11 \$2,833,335, a difference of \$862,000.** [Jorgensen]
12 listed the tax basis for federal purposes on the 2000
13 return at \$3,695,335 and California state tax basis at
14 \$2,833,335, with no explanation for the difference.
15 This is a significant and obvious inaccuracy.

16 Second Amended Complaint ¶ 16, September 4, 2019, ECF # 56 (emphasis
17 added).

18 For each following tax year until 2015, Jorgensen replicated the
19 error, understating the Aluisis' depreciation expenses on their state
20 income tax returns, and thereby creating an unnecessary tax liability
21 for Aluisis.

22 In October 2015, while preparing the Aluisis' 2014 income tax
23 returns, Jorgensen discovered his error. In the pertinent part, the
24 Aluisis have pled:

25 It is clear that [Jorgensen] caught his error of the
26 incorrect State tax basis during preparation of
27 [Aluisis'] 2014 tax returns[,] which were filed on
28 extension on October 15, 2015, because [Jorgensen]
deliberately changed the correct Federal Tax basis in
the amount of \$3,695,635 to match the lower incorrect
California tax basis in the amount of \$2,833,335. . .
Further, by [Jorgensen] lowering the correct Federal
tax basis of The Trading Post transaction to the
incorrect California income tax basis, [Jorgensen]
knew that this would result in less scrutiny than
raising the incorrect California basis to the correct
Federal basis without any explanation or acquisition
that would support the higher basis. . .

Second Amended Complaint at ¶ 17(G).

Jorgensen did not disclose his error to Aluisis. For their
income tax returns for 2014 and for each subsequent year, Jorgensen

1 lowered the tax basis claimed on the federal income tax return to
2 \$2,833,335 to match the lower, and erroneous, tax basis claimed on the
3 state income tax return.

4 Dissatisfied with Jorgensen's services, the Aluisis terminated
5 their relationship with him and hired Christopher Morse ("Morse"), a
6 Certified Public Accountant. In 2017, Morse advised Aluisis of
7 Jorgensen's understatement of the tax basis claimed on their state
8 income tax returns. When Morse asked Jorgensen to explain the
9 discrepancy, Jorgensen gave differing and false explanations:

10 When [Aluisis'] successor tax preparer met with
11 [Jorgensen] to obtain information concerning the
12 inconsistency between the California state and federal
13 bases for The Trading Post, [Jorgensen] produced no
14 tax work papers and claimed to have no knowledge of
15 why or explanation for the tax basis discrepancy. . .
16 Subsequently, [Jorgensen] testified that a fire
17 destroyed the records and work papers involving the
18 preparation of the 2000 tax return that reported the
19 1031 Exchange for the acquisition of The Trading Post.
20 [Jorgensen] claimed that he needed these records to
21 determine why the state income tax basis was
22 substantially lower than the federal tax basis. To
23 "cover up" his errors, [Jorgensen] stated the records
24 were destroyed in the fire. This was an intentional
25 misstatement . . .

26 Second Amended Complaint at ¶ 12 (emphasis added).

27 With Morse's assistance the Aluisis were able to amend their
28 returns as far back as the 2013 tax year. Applicable tax law
precluded amendments beyond that date.

Aluisis allege the following damages as a result of Jorgensen's
conduct: lost depreciation of \$45,000 between the years 2000 and 2013;
accounting fees paid to Jorgensen of \$48,000; and additional
accounting fees paid to Morse of \$6,325.

29 B. Section 1031 Exchange of The Trading Post

30 In 2013, the Aluisis commenced negotiations with a buyer to sell

1 The Trading Post and in 2014 the Aluisis entered into a contract to
2 sell The Trading post using a "\$ 1031 Exchange."¹ A § 1031 Exchange is
3 a tax strategy, sanctioned by the Internal Revenue Code, that allows
4 deferral of gains on the sale of investment property provided a like-
5 kind property is purchased with the gain from the sale of the first
6 property. Section 1031 Exchanges are subject to stringent
7 requirements. Sellers may not receive cash distributions, known as
8 "cash boot," or reduce the amount of secured debt from the first to
9 the second property, known as "mortgage boot." A seller's failure to
10 comply fully with Internal Revenue Service regulations governing §
11 1031 Exchanges forfeits deferral of the tax on the gain.

12 Throughout the process the Aluisis consulted with Jorgensen and
13 discussed with him their goal of emerging from the § 1031 Exchange
14 with different investment properties that were unencumbered. The
15 Aluisis' plan was to sell The Trading Post for \$11,500,000, retire
16 secured debt against The Trading Post of \$5,500,000, retain \$1,000,000
17 cash and purchase other properties with the remaining \$5,000,000. The
18 Aluisis were aware that retaining \$1,000,000 was taxable as cash boot;
19 they were unaware that the reduction in secured debt, i.e., payoff of
20 the \$5,500,000, would also be taxable as mortgage boot. Jorgensen
21 told them that their plan was "sound," "solid," and "valid."
22 Jorgensen did not warn them about the mortgage boot problem.

23 Unaware that proceeding with the sale would create a substantial
24 tax on the mortgage boot, the Aluisis proceeded with the sale of The
25 Trading Post and reinvestment of sale proceeds. As a result, the
26 Aluisis owed an additional, and unexpected, \$2,300,000 in taxes.

27 Aluisis contend that Jorgensen knew that their plan to step down

28 ¹ 26 U.S.C. § 1031

1 the amount of their secured debt would defeat the goal of tax deferral
2 and would generate a tax for the year in which the sale occurred.
3 They allege that Jorgensen was an experienced accountant who had
4 "handled" § 1031 Exchanges previously:

5 As a Certified Public Accountant, [Jorgensen] was
6 knowledgeable with the requirements of 1031s and any
7 rule changes to the 1031 process through his
8 continuing education (80 hours every 2 years). In
9 fact, [Jorgensen] had handled the original 1031
10 Exchange leading to the acquisition of The Trading
Post in 2000. Further, [Jorgensen], in sworn
testimony in the State Court case testified that he
was an **experienced CPA with direct knowledge of 1031
Exchanges from having handled between 20 to 40 . . .**

11 Second Amended Complaint ¶ 27 (emphasis added).

12 Aluisis also allege that he knew a tax would result:

13 [Jorgensen] advised [Aluisis] that their plan was a
14 sound plan and gave them no warning about the
15 "mortgage boot" issue. **As a Certified Public**
16 **Accountant with substantial 1031 Exchange experience,**
17 **[Jorgensen] knew that a substantial tax liability**
18 **would flow from their strategy** and that harm would
19 occur and that [Aluisis] would be deceived to their
20 detriment by [Jorgensen's] false statements . . .

21 As hereinbefore alleged, [Jorgensen] made
22 misrepresentations and fraudulent omissions in
23 connection with his advice to [Aluisis] regarding
24 their plan concerning the 1031 Exchange of The Trading
25 Post by telling [Aluisis] their plan regarding the
26 1031 Exchange was a valid plan. **[Jorgensen] knew of**
27 **the falsity and deceptiveness of his advice at the**
28 **time it occurred; [Jorgensen] knew of that [Aluisis]**
would incur tax penalties if they proceeded with the
plan they had explained to him . . .

23 Second Amended Complaint at ¶¶ 33, 36 (emphasis added).

24 In 2017, Aluisis brought a professional negligence action against
25 Jorgenson in state court.

26 **II. PROCEDURE**

27 In 2018, before the state court action could be resolved,
28 Jorgenson and his spouse, Laura, sought the protections of a chapter

1 13 bankruptcy.

2 The Aluisis brought an adversary proceeding against Jorgensen to
3 except his debt to them from the discharge. 11 U.S.C. §§
4 523(a)(2)(A), 1328(a). They contend that Jorgenson was aware of his
5 professional negligence, e.g., underreporting their tax-basis and
6 giving incorrect advice with respect to a tax-deferred real estate
7 transaction and concealing those mistakes from them.

8 On two prior occasions, Jorgensen challenged the sufficiency of
9 the Aluisis' complaint by motion to dismiss. On each occasion this
10 court has granted Jorgensen's motion to dismiss, giving Aluisis leave
11 to amend their complaint.

12 Aluisis filed a Second Amended Complaint alleging two counts of
13 non-dischargeable fraud under § 523(a)(2)(A), i.e., lost depreciation
14 between 2000-2015 and unnecessary tax liabilities arising from the
15 mortgage boot for the sale of The Trading Post. Jorgensen has moved
16 to dismiss the Second Amended Complaint, arguing that the Aluisis have
17 not pled facts from which the court may find anything beyond
18 professional negligence. Aluisis oppose the motion.

19 **III. JURISDICTION**

20 This court has jurisdiction. 28 U.S.C. § 1334(a)-(b); *see also*
21 General Order No. 182 of the Eastern District of California. This is
22 a core proceeding. 28 U.S.C. § 157(b)(2)(I). The plaintiffs have
23 consented to final orders and judgments by this court. Second Amended
24 Complaint at ¶ 4.

25 **IV. LAW**

26 **A. Rule 12(b)(6)**

27 Under Federal Rule of Civil Procedure 12(b)(6), a party may move
28 to dismiss a complaint for "failure to state a claim upon which relief

1 can be granted." Fed. R. Civ. P. 12(b)(6), *incorporated by* Fed. R.
2 Bankr. P. 7012(b). "A Rule 12(b)(6) dismissal may be based on either
3 a lack of a cognizable legal theory or the absence of sufficient facts
4 alleged under a cognizable legal theory." *Johnson v. Riverside*
5 *Healthcare Sys., LP*, 534 F.3d 1116, 1121-22 (9th Cir. 2008); *accord*
6 *Navarro v. Block*, 250 F.3d 729, 732 (9th Cir. 2001). "To survive a
7 motion to dismiss, a complaint must contain sufficient factual matter,
8 accepted as true, to 'state a claim to relief that is plausible on its
9 face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell*
10 *Atl. Corp. v. Twombly*, 550 U.S. 544, 556, 570 (2007)).

11 After *Iqbal* and *Twombly*, courts employ a three-step analysis in
12 deciding Rule 12(b)(6) motions. At the outset, the court takes notice
13 of the elements of the claim to be stated. *Eclectic Properties East,*
14 *LLC v. Marcus & Millichap Co.*, 751 F.3d 990, 997 (9th Cir. 2014).
15 Next, the court discards conclusions. *Ashcroft v. Iqbal*, 556 U.S.
16 662, 679 (2009); *United States ex rel. Harper v. Muskingum Watershed*
17 *Conservancy District*, 842 F.3d 430, 438 (6th Cir. 2016) (the complaint
18 failed to include "facts that show how" the defendant would have known
19 alleged facts). Finally, assuming the truth of the remaining well-
20 pleaded facts, and drawing all reasonable inferences therefrom, the
21 court determines whether the allegations in the complaint "plausibly
22 give rise to an entitlement to relief." *Iqbal*, 556 U.S. at 679;
23 *Sanchez v. United States Dept. of Energy*, 870 F.3d 1185, 1199 (10th
24 Cir. 2017). See generally, *Wagstaff Practice Guide: Federal Civil*
25 *Procedure Before Trial*, Attacking the Pleadings, Motions to Dismiss §
26 23.75-23.77 (Matthew Bender & Company, Inc. 2019).

27 Plausibility means that the plaintiff's entitlement to relief is
28 more than possible. *Twombly*, 550 U.S. at 570 (the facts plead "must

1 cross the line from conceivable to plausible"); *Almanza v. United*
2 *Airlines, Inc.*, 851 F.3d 1060, 1074 (11 Cir. 2017). Allegations that
3 are "merely consistent" with liability are insufficient. *Iqbal*, 556
4 U.S. at 662; *McCauley v. City of Chicago*, 671 F.3d 611, 616 (7th Cir.
5 2011).

6 If the facts give rise to two competing inferences, one of which
7 supports liability and the other of which does not, the plaintiff will
8 be deemed to have stated a plausible claim within the meaning of *Iqbal*
9 and *Twombly*. *Houck v. Substitute Tr. Servs., Inc.*, 791 F.3d 473, 484
10 (4th Cir. 2015); *16630 Southfield Ltd. P'hsip v. Flagstar Bank,*
11 *F.S.B.*, 727 F.3d 502, 505 (6th Cir. 2013); *see also, Wagstaff*, Motion
12 to Dismiss at § 23.95. But if one of the competing inferences is
13 sufficiently strong as to constitute an "obvious alternative
14 explanation," that inference defeats a finding of plausibility and the
15 complaint should be dismissed. *Marcus & Millichap Co.*, 751 F.3d at
16 996 ("Plaintiff's complaint may be dismissed only when defendant's
17 plausible alternative explanation is so convincing that the
18 plaintiff's explanation is implausible."); *New Jersey Carpenters*
19 *Health Fund v. Royal Bank of Scotland Group, PLC*, 709 F.3d 109, 121
20 (2nd Cir. 2013).

21 Since this is a claim alleging fraud, Rule 9(b) also applies.
22 *See, e.g., Chase Bank, U.S.A., N.A. v. Vanarthos (In re Vanarthos)*,
23 445 B.R. 257, 264 (Bankr. S.D.N.Y. 2011). This rule's heightened
24 pleading standard requires a plaintiff to "state with particularity
25 the circumstances constituting fraud." Fed. R. Civ. P. 9(b),
26 *incorporated by* Fed. R. Bankr. P. 7009. This standard means that
27 "the complaint must set forth what is false or misleading about a
28 statement, and why it is false." *Rubke v. Capitol Bancorp Ltd.*, 551

1 F.3d 1156, 1161 (9th Cir. 2009) (quoting *Yourish v. Cal. Amplifier*,
2 191 F.3d 983, 993 (9th Cir. 1999)) (internal quotation marks omitted).
3 The facts constituting fraud must be pled specifically enough to give
4 a defendant sufficient "notice of the particular misconduct" so that
5 defendant may defend against the charge. *Vess v. Ciba-Geigy Corp.*
6 *U.S.A.*, 317 F.3d 1097, 1106 (9th Cir. 2003). A plaintiff must include
7 the "who, what, when, where, and how" of the fraud. *Id.*

8 **B. 11 U.S.C. § 523(a)(2)(A)**

9 Section 523 excepts debts incurred by fraud from discharge. 11
10 U.S.C. § 523(a)(2)(A). To except a debt from discharge under §
11 523(a)(2)(A) the creditor must plead and, by a preponderance of the
12 evidence, prove:

13 (1) misrepresentation(s), fraudulent omission(s), or
14 deceptive conduct; (2) knowledge of the falsity or
15 deceptiveness of such representation(s), omission(s),
16 or conduct; (3) an intent to deceive; (4) justifiable
reliance by the creditor; and (5) damage to the
creditor proximately caused by its reliance.

17 *In re Shannon*, 553 B.R. 380, 388 (9th Cir. BAP 2016), citing *Ghomeshi*
18 *v. Sabban* (*In re Sabban*), 600 F.3d 1219, 1222 (9th Cir.2010).

19 An omission may give rise to an exception to discharge under §
20 523(a)(2)(A) if the debtor was under a duty to make disclosure.
21 *Tallant v Kaufman* (*In re Tallant*), 218 B.R. 58, 64-65 (9th Cir. BAP
22 1998) (attorney). The Ninth Circuit has adopted the test articulated
23 by the Restatement (Second) of Torts (1976) for deciding whether a
24 defendant has a duty to make disclosure. *Apte v. Japra* (*In re Apte*),
25 96 F.3d 1319, 1323-24 (9th Cir. 1996). The Restatement provides:

26 (1) One who fails to disclose to another a fact that
27 he knows may justifiably induce the other to act or
28 refrain from acting in a business transaction is
subject to the same liability to the other as though
he had represented the nonexistence of the matter that

1 he has failed to disclose, if, but only if, he is
2 under a duty to the other to exercise reasonable care
to disclose the matter in question.

3 (2) One party to a business transaction is under a
4 duty to exercise reasonable care to disclose to the
other before the transaction is consummated,

5 (a) matters known to him that the other is
6 entitled to know because of a fiduciary or other
similar relation of trust and confidence between
7 them; and

8 . . .
9 (c) subsequently acquired information that he knows
will make untrue or misleading a previous
representation that when made was true or believed to
be so . . .

10 Rest.2d Torts at § 551(1),(2)(a),(b); Cf., Treasury Department
11 Circular No. 230, § 10.21 (requiring an accountant to advise client of
12 the existence of an error on prior year's return).

13 At issue is whether the Second Amended Complaint pleads facts
14 from which Jorgensen's knowledge under § 523(a)(2)(A) may plausibly be
15 inferred.²

16 V. DISCUSSION

17 "Knowledge" of the falsity of the representation requires "actual
18 knowledge of the falsity of a statement" or "reckless indifference" to
19 the truth. *Morimura, Ari & Co. v. Taback*, 279 U.S. 24, 33 (1929);
20 *Anastas v. Am. Savings Bank (In re Anastas)*, 94 F.3d 1280, 1286 (9th
21 Cir. 1996); *Advanta Nat. Bank v. Kong (In re Kong)*, 239 B.R. 815, 826-
22 67 (9th Cir. BAP 1999). Reckless conduct requires something beyond
23 "simple or inexcusable negligence." *Hirth v. Donovan (In re Hirth)*,
24

25 ² Affidavits and declarations may not be attached as exhibits to the
26 complaint. Fed. R. Civ. P. 10(c), incorporated by Fed. R. Bankr. P. 7010.
27 *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003). During oral
28 argument the plaintiffs concede this point. As a result, the opinions of
Susan E. Bradley and James P. Braun will not be considered and the court will
issue an order granting its own motion to strike the Compendium of Exhibits
to the Second Amended Complaint, September 4, 2019, ECF # 58.

1 2014 WL 7048395 *11 (9th Cir. BAP December 11, 2014).

2 **A. First Count: Depreciation for The Trading Post**

3 **1. Have Aluisis' pled the existence of a debt within the**
4 **meaning of § 523(a)?**

5 State law governs whether a "debt" under § 523(a) exists; federal
6 law determines whether that debt is dischargeable. *Grogan v. Garner*,
7 498 U.S. 279, 283-84 (1991); *Northbay Wellness Group, Inc. v. Beyries*,
8 789 F.3d 956, 959 n. 3 (9th Cir. 2015).

9 Jorgensen's actions give rise to two disputed, unliquidated
10 claims. The first is but a single claim for professional negligence.
11 Under California law all injuries flowing from the violation of one
12 primary right constitute but a single cause of action. *Pointe San*
13 *Diego Residential Community, L.P. v. Procopio, Cory, Hargreaves &*
14 *Savitch, LLP*, 195 Cal.App.4th 265, 274-75 (2011) (multiple acts of
15 legal malpractice); *Cyr v. McGovran*, 206 Cal.App.4th 645, 652 (2012)
16 (realtor malpractice); *Richard B. LeVine, Inc. v. Higashi*, 131
17 Cal.App.4th 566, 575 (2005) (accounting malpractice and fraud). Where
18 the wrongdoing causes successive injuries over time, such single cause
19 of action supports multiple theories of relief. *Big Boy Drilling*
20 *Corp. v. Rankin*, 213 Cal. 646, 648 (1931); *San Diego Water Co. v. San*
21 *Diego Flume Co.*, 108 Cal. 549, 556 (1895). As pertinent here, the
22 Aluisis' claim spans the 15 years that Jorgensen understated the
23 allowed amount of depreciation for The Trading Post.

24 The second is a claim for fraudulent concealment. Concealment
25 may give rise to a state law claim for fraud. *Hahn v. Mirda*, 147
26 Cal.App.4th 740 (2007) (physician's concealment of revised prognosis);
27 *Boschma v. Home Loan Center, Inc.*, 198 Cal.App.4th 230, 248 (2011).
28 As pled, this claim has a far more limited reach. According to the

1 Aluisis, the first fraudulent concealment occurred on or about October
2 15, 2015, and would only capture damages flowing from the
3 misstatement. This is a markedly shorter period than the damages
4 arising from the professional negligence. The Aluisis have pled the
5 existence of two state law debts.

6 **2. Have the Aluisis pled a debt excepted from discharge**
7 **under § 523(a)?**

8 Debts arising from fraud will be excepted from discharge; debts
9 arising from negligence will not be excepted from discharge.

10 As pertinent here, the Aluisis have pled facts from which an
11 inference of Jorgensen's knowledge as of October 15, 2015, may be
12 drawn. Those facts are: Jorgensen's reduction in the long-standing
13 federal income tax basis from \$3,695,335 to \$2,833,335; understatement
14 of the federal income tax bases from 2014 federal income tax return
15 forward; and Jorgensen's inability to explain the discrepancy between
16 the returns and his false statements as to why he was unable to
17 produce his working papers from which the depreciation allowance was
18 claimed. Second Amended Complaint at ¶¶ 12, 17(G).

19 **3. Granting a Rule 12(b)(6) motion as to the professional**
20 **negligence claim only.**

21 Though the Ninth Circuit has not addressed the issue, most courts
22 believe that a Rule 12(b)(6) motion may not be granted as to only part
23 of a claim. *BBL, Inc. v. City of Angola*, 809 F.3d 317, 325 (7th Cir.
24 2015); *Thompson v. Paul*, 657 F.Supp.2d 1113, 1129 (D. Ariz. 2009)
25 (construing motion under Rule 12(b)(6) as motion under Rule 12(f));
26 *contra, Hill v. Opus Corp.*, 841 F.Supp.2d 1070, 1082 (C.D. Cal. 2011).
27 But even those courts that are not inclined to grant relief under Rule
28 12(b)(6) agree that the same result may be reached under 12(f)(1)

1 (allowing sua sponte relief). Fed. R. Civ. P. 12(f)(1), *incorporated*
2 *by* Fed. R. Bankr. 7012(b).

3 In this case, the Aluisis have pled a cause of action under §
4 523(a)(2)(A) premised on two different state law claims: negligence
5 and fraud. The negligence claim is dischargeable; the fraud claim may
6 be excepted from discharge. 11 U.S.C. §§ 523(a)(2)(A),(c) (provided a
7 timely adversary proceeding is filed); Fed. R. Bankr. P. 4007(c);
8 *Younie v. Gonya (In re Younie)*, 211 B.R. 367, 373-74 (9th Cir. BAP
9 1997), *aff'd* 163 F.3d 609 (9th Cir.1998) (noting the identity of
10 elements between § 523(a)(2)(A) and California common law fraud).
11 These very different causes of action give rise to very different
12 rights under the bankruptcy code.

13 The professional negligence claim spans from 2000 to 2015 and
14 seeks damages in the form of lost depreciation expense and ancillary
15 costs, e.g., additional accounting fees. Professional negligence
16 alone will not support a claim of fraud under § 523(a)(2)(A). The
17 motion to dismiss will be granted insofar as the "debt," 11 U.S.C. §
18 523(a), precedes Jorgensen's first knowing misrepresentation, i.e.,
19 October 15, 2015.

20 In contrast, fraud is nondischargeable and, in this case, gives
21 rise to a narrower species of damages. Since the fraud occurred
22 starting in October 2015, fewer years are involved. Moreover, fraud
23 damages are limited to those "traceable to" or "resulting from" the
24 fraudulent conduct. *Field v. Mans*, 516 U.S. 59, 64 (1995); *Cohen v. de*
25 *la Cruz*, 523 U.S. 213, 218 (1998); *Ghomesh v. Sabban (In re Sabban)*,
26 600 F.3d 1219, 1224 (9th Cir. 2010) (monetary award against unlicensed
27 contractor not excepted from discharge where the client suffered no
28 actual harm as result of the misrepresentations of licensure).

1 Here, fraud damages are limited to uncaptured depreciation
2 incurred after the October 15, 2015, misrepresentation, i.e., tax
3 years after 2014, and for tax years preceding 2015 for which amendment
4 was still possible, i.e., 2011-2015, Cal. Rev. & Tax Code § 19306
5 (specifying a four-year look back period), as well as ancillary
6 damages flowing therefrom. Consequently, the court will grant the
7 motion as to any claim prior to 2011 and will deny the motion as to
8 any claim on or after 2011.

9 **B. Second Count: § 1031 Exchange of The Trading Post**

10 After *Iqbal* and *Twombly*, the naked assertion that a defendant
11 "knew" a particular representation was false is insufficient to plead
12 a plausible claim for fraud. *Iqbal*, 556 U.S. at 686-687; *Zayed v.*
13 *Associated Bank, N.A.*, 779 F.3d 727, 732-734 (8th Cir. 2015). Rather,
14 the complaint must plead "specific underlying facts from which we can
15 reasonably infer the requisite intent." *In re BP Lubricants USA,*
16 *Inc.*, 637 F.3d 1307, 1312 (Fed. Cir. 2011).

17 "Knowledge" requires consciousness of the falsity:

18 **A misrepresentation is fraudulent if the maker (a)**
19 **knows or believes that the matter is not as he**
20 **represents it to be, (b) does not have the confidence**
21 **in the accuracy of his representation that he states**
22 **or implies, or (c) knows that he does not have the**
23 **basis for his representation that he states or**
24 **implies.**

25 Rest.2d Torts at § 526 (emphasis added); *Field v. Mans*, 516 U.S. 59,
26 68-70 (1998) (recognizing Restatement (Second) Torts as construing §
27 523(a)(2)(A)); see also, *Citibank v. Eashai (In re Eashai)*, 87 F.3d
28 1082, 1089 (9th Cir. 1996).

29 The comments to § 526 of the Second Restatement make this even
30 clearer. "[F]raudulent" refers "solely to the maker's knowledge of
31 the untrue character of his representation." Rest.2d Torts at § 526.

1 The standard is not an objective one.

2 **The fact that the misrepresentation is one that a man**
3 **of ordinary care and intelligence in the maker's**
4 **situation would have recognized as false is not enough**
5 **to impose liability upon the maker for a fraudulent**
6 **misrepresentation** under the rule stated in this
7 Section, but it is evidence from which his lack of
8 honest belief may be inferred. . .

9 *Id.* at Comment on Clause (a) (emphasis added).

10 The Aluisis have alleged that Jorgensen actually "knew" that "a
11 substantial tax liability would flow" from their intended course of
12 action. Second Amended Complaint ¶¶ 33, 36. Aluisis have not alleged
13 that Jorgensen acted with a "reckless indifference" for the truth,
14 *Morimura, Ari & Co.*, 279 U.S. at 33, nor that Jorgensen "believe[d]
15 that the matter is not as he represents it to be." Rest.2d Torts at §
16 526(a).

17 The Aluisis have only alleged two underlying facts from which an
18 inference of knowledge might be drawn as to "how," *Muskingum Watershed*
19 *Conservancy District*, 842 F.3d at 438, Jorgensen knew that the
20 mortgage boot provisions would be operative: that over his 50-year
21 career he had handled between 20-40 § 1031 Exchanges and that he
22 attended not less than 80 hours of continuing accountancy education
23 every two years.³

24 These facts give rise to two possible interpretations. The first
25 explanation is that Jorgensen missed the mortgage boot issue, giving
26

27 ³ Some courts believe that asymmetry of information, such as knowledge in
28 fraud, provides a basis to offer a plaintiff greater latitude in pleading
plausibility. *United States ex rel. Presser v. Acacia Mental Health Clinic,*
LLC, 836 F.3d 770, 778 (7th Cir. 2016); *Saldivar v. Racine*, 818 F.3d 14, 23
(1st Cir. 2016). If the Ninth Circuit recognizes the asymmetry of
information as a basis to relax the elements of *Iqbal* and *Twombly* it is not
applicable here. Prior to filing this adversary proceeding the Aluisis sued
Jorgensen in state court and engaged in discovery, including taking
Jorgensen's deposition. Second Amended Complaint ¶¶ 31-32. As a result, to
the greatest extent possible, any asymmetry has been remedied.

1 rise to a claim for professional negligence. Section 1031 Exchanges
2 are "complex, nuanced, and strict[.]" *San Francisco Club, Inc. v.*
3 *Baswell-Guthrie*, 897 F.Supp.2d 1122, 1130 (N.D. Ala. 2012); *see also*,
4 26 C.F.R. §§ 1.1031(a)-1-1.1031(k)-1. Jorgensen only handled one such
5 transaction for his clients every year--or perhaps every two years--
6 over the course of his 50-year career. These facts fit neatly within
7 a simple negligence model. The second interpretation of the facts is
8 that Jorgensen was actually aware of the mortgage boot issue but
9 decided to conceal it from the Aluisis. The facts fit only roughly
10 into such a model. And while the court should not, and will not,
11 weigh competing inferences, it does find that negligence is an obvious
12 alternative explanation, rendering an inference of fraud not
13 plausible. Consequently, the motion will be granted.

14 **C. Leave to Amend**

15 Federal Rule of Civil Procedure 15(a) provides that leave to
16 amend "shall be freely given when justice so requires." In
17 determining whether to grant leave to amend the court should consider
18 five factors: bad faith, undue delay, prejudice, futility, and
19 previous amendments. *Johnson v. Buckley*, 356 F.3d 1067, 1077 (9th
20 Cir. 2004). "Futility alone can justify" denying leave to amend.
21 *Nunes v. Ashcroft*, 375 F.3d 805, 808 (9th Cir. 2004). Here, the
22 Aluisis have plead their case three times. Any further effort would
23 be futile.

24 **VI. CONCLUSION**

25 As to Count I, the motion to dismiss will be granted as to the
26 Aluisis' fraud claim for each year prior to the 2011 tax year and will
27 otherwise be denied. As to Count II, the motion will be granted.
28 Aluisis' request for leave to file a Third Amended Complaint will be

1 denied. The court will issue an order from chambers.

2 Dated: December 10, 2019

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5 _____/s/_____
Fredrick E. Clement
6 United States Bankruptcy Judge
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