

1 APPEARANCES

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TUESDAY, MARCH 26, 2019 - 9:17 A.M.

ALJ MARGOLIS: We're on the record in the appeal of William Llanos, OTA Case No. 18010692. The date is March 26, 2019, and this hearing is being held in Sacramento, California before Judges Jeffrey Margolis, Andrew Kwee, and Neil Robinson.

Will the parties and their representatives please identify themselves for the record, starting with the taxpayer and his representative.

THE APPELLANT: William Llanos.

ALJ MARGOLIS: Yes.

MR. POLK: David William representing the taxpayer.

ALJ MARGOLIS: Mr. William, you appeared before the Office of Tax Appeals in February, and you identified yourself as David Polk. I just want to make sure we have your proper name and address in the record here today. What is your --

MR. POLK: It's David William Polk.

ALJ MARGOLIS: It's David William Polk, and how would you like me to refer to you today, as Mr. Polk or Mr. William?

MR. POLK: Either one is fine.

ALJ MARGOLIS: Okay. And also, I want to

1 make sure we have your correct address because the
2 address on your power of attorney in this case is
3 different than the address than the power of attorney
4 in the Janelle Polk [sic] case.

5 MR. POLK: All right. I'm sorry, what do you
6 have?

7 ALJ MARGOLIS: Well, in this case it says
8 care of West Burbank Boulevard, No. 262, Burbank,
9 California. In the Janelle Polk [sic] case, it's on
10 916 West Burbank Boulevard, Suite C.

11 MR. POLK: It's the same address, it's just
12 written incorrectly. It is 916 -- the 262 -- it's 916
13 C West Burbank Boulevard, No. 262.

14 ALJ MARGOLIS: So there's no Suite C? Is it
15 Suite C as well?

16 MR. POLK: Yes, the C goes on it. It's 916
17 C.

18 ALJ MARGOLIS: 916 C West Burbank Boulevard?

19 MR. POLK: Correct. Yeah. Sorry. I guess
20 that was just written incorrectly.

21 ALJ MARGOLIS: 916, and then is there a
22 number 262 as well?

23 MR. POLK: Yes.

24 ALJ MARGOLIS: Number 262. Okay. We'll make
25 that change in our records for this case.

1 And Mr. Llanos, I just want to make sure you
2 want to proceed here today with Mr. Polk as your
3 representative; correct?

4 THE APPELLANT: Yes.

5 ALJ MARGOLIS: Okay. Would the FTB please
6 identify themselves for the record.

7 MR. AMARA: Sure. Andrew Amara for the
8 Franchise Tax Board, and then I'm here with Nancy
9 Parker as well.

10 ALJ MARGOLIS: Okay. Thank you. The issues
11 in this appeal, as agreed to in pre-hearing
12 conference, are, as I understand, the following:
13 Whether FTB's proposed tax assessment for 2012 is
14 proper and correct; second, whether Appellant is
15 liable for the late filing and demand penalties
16 proposed by the FTB; and third, whether a frivolous
17 appeal penalty should be imposed, and if so, in what
18 amount.

19 Do the parties agree that that correctly
20 states the issues to be decided today?

21 MR. POLK: Yes.

22 MR. AMARA: Correct, Judge.

23 ALJ MARGOLIS: Thank you. And then at the
24 pre-hearing conference, both parties indicated they
25 did not intend to call any witnesses; is that still

1 correct?

2 MR. POLK: Correct.

3 MR. AMARA: Correct.

4 ALJ MARGOLIS: Okay. Let's go over the
5 exhibits that the parties asked to be admitted into
6 evidence today. Let's start with Petitioner's
7 exhibits.

8 Petitioner's Exhibits 1 through 10, I believe
9 there was no objection by Respondent to any of those;
10 is that correct?

11 MR. AMARA: Correct, Judge.

12 ALJ MARGOLIS: Okay. Those exhibits will be
13 admitted.

14 (Appellant's Exhibits 1-10
15 admitted into evidence.)

16 ALJ MARGOLIS: Then there are some new
17 exhibits, Exhibits 11 through 18.

18 What's the FTB's position on these exhibits?

19 MR. AMARA: We don't have any issue with
20 those, Judge.

21 ALJ MARGOLIS: I do have a problem with two
22 of these exhibits in that they kind of circumvent our
23 rules, the declaration of Mr. Llanos. Mr. Llanos is
24 here, he could testify here. We don't allow
25 declarations, as you may recall, we kept out the

1 declaration at your request of Mr. McDonald. So I
2 think that for fair play, if someone's not going to be
3 here to testify, I mean, he is available to testify if
4 you want, but I'm not going to allow his declaration
5 into evidence.

6 MR. POLK: Can we admit it as argument?

7 ALJ MARGOLIS: Yes, we can admit it as
8 argument.

9 MR. POLK: Okay. That's fine.

10 ALJ MARGOLIS: And also, you submitted
11 additional briefing in terms of Exhibit 16. That
12 circumvents our rules on filing additional briefs.
13 You didn't ask for permission to file additional
14 briefs.

15 As you recall, at our pre-hearing conference,
16 when Mr. Amara asked for permission to provide
17 additional authorities for us, I told him that I
18 didn't want them submitted in the form of an
19 additional brief, I just wanted him to mention them in
20 his argument if he thought they were significant. And
21 I ask that you do the same with respect to the
22 authorities that you raised in Exhibit 16.

23 MR. POLK: With all due respect, Judge, the
24 FTB has been allowed to submit legal arguments as
25 argument, they have a memo with --

1 ALJ MARGOLIS: You are allowed to submit
2 them, but you need to submit them in accordance with
3 the pre-hearing rules about submitting briefs.

4 MR. POLK: Okay.

5 ALJ MARGOLIS: So I'm going to exclude those.
6 Other than that, Exhibits 11 through 15, and 18 will
7 be admitted without qualification. Exhibit 16 will be
8 excluded, and Exhibit 17 will be admitted as an
9 argument.

10 (Appellant's Exhibits 11-15, 18
11 admitted without qualification.)

12 (Appellant's Exhibit 17 admitted
13 as argument.)

14 MR. POLK: Sorry, Judge. Just for the
15 record, I want to object to your keeping out
16 Exhibit 16 because it goes to the -- just for the
17 record, just want to object it goes to the
18 reasonableness of the appellant's position in his
19 determinations.

20 ALJ MARGOLIS: Okay. Your objection is duly
21 noted for the record.

22 MR. POLK: Okay.

23 ALJ MARGOLIS: Let's move on to the FTB's
24 exhibits. At our pre-hearing conference, I indicated
25 that I would admit Exhibits A through B, as well as

1 Exhibit -- no -- A through U, as well as Exhibit X.
2 And I know that Mr. Polk, you made several objections.
3 I will note them for the record for you.

4 With respect to Exhibit F, Appellant's
5 Protest -- oh, no, I'm sorry.

6 Exhibit F, I agreed to sustain your objection
7 to the protest. That will be excluded.

8 MR. AMARA: Can we just go on the record to
9 indicate our position on that Exhibit F? I can wait
10 until you get through everything.

11 ALJ MARGOLIS: No, you may go on the record.
12 Please be brief.

13 MR. AMARA: I will. So we would contest the
14 lack of admissibility of that Exhibit F. That's
15 Appellant's protest. There's a statutory protest
16 process that FTB is required to follow, Revenue
17 Taxation Code Section 19041 and 19045. That goes to
18 not only full due process here, but it shows the
19 entire appeal process was followed by FTB.

20 So our position is that protest
21 correspondence should come in because, again, it's
22 relevant to show that the entire appeals process
23 according to taxpayers as well.

24 And then also, it's relevant to the frivolous
25 appeal matter that is under consideration here as

1 well. I just wanted to go on the record on that.

2 ALJ MARGOLIS: Thank you. Our ruling stands
3 on that, but you're certainly permitted to make your
4 objection for the record.

5 For with respect to Exhibit H. H, I believe,
6 Mr. Polk, you objected to on the grounds of relevance,
7 and I'm overruling that objection.

8 With respect to I, the employer's declaration
9 verifying wages, I am excluding the declaration, but I
10 am admitting the W-2 as a business record. You're
11 objecting to that on the grounds of relevance, I
12 believe.

13 MR. POLK: Yeah. I'm objecting to the W-2
14 form, that's a new objection. But we already have a
15 federal wage transcript in exhibits with the same
16 information. So it's redundant and I don't see that
17 it proves anything beyond. And also, we have an
18 admission that the money was received. So I'm not
19 sure what the W-2 is supposed to prove.

20 ALJ MARGOLIS: Okay. Your objection is
21 overruled.

22 Next, with respect to the EDD wage record,
23 Exhibits J and K and 2012 wage and income transcript.
24 At the pre-hearing conference you raised no objection,
25 but since that time you sought a statement of

1 objections to those exhibits.

2 MR. POLK: I withdraw the objection to
3 Exhibit K with no objection to that.

4 ALJ MARGOLIS: Okay. That will be admitted.

5 MR. POLK: However, D -- I'm sorry, J, the
6 EDD wage record contains the same information as the
7 federal wage and income transcript and the W-2, so
8 it's redundant, and just don't know what that's
9 supposed to prove.

10 ALJ MARGOLIS: Okay. I'm going to admit it
11 as a business record and we will overrule your
12 objection.

13 Let's move on to Exhibit L, the law summary.
14 At the pre-hearing conference I had said that we will
15 exclude it. We will allow it only as evidence that it
16 was mailed to the taxpayer, mailed and received by the
17 taxpayer. And that's my ruling on that.

18 With respect to Exhibits M through Q, those
19 are demands for prior year's tax returns. You
20 objected on the grounds of relevance. I'm overruling
21 that objection. I think they are relevant.

22 Exhibits R and S, there was no objection and
23 those will be admitted.

24 Exhibit T, the Form 1040 for the tax year
25 2015, you objected to the grounds of relevance.

1 Pre-hearing conference, I indicated I would overrule
2 that objection, and I am overruling that objection.

3 Exhibit U and X, you had no objection to, and
4 those will be admitted.

5 And you have objections to Exhibits V and W
6 on the grounds of relevance. And I agreed to sustain
7 your objections to Exhibit V and W.

8 Mr. Amara, do you want to be heard in any of
9 those other exhibits?

10 MR. AMARA: Just with respect to Exhibit I,
11 the declaration, our position is that the declaration
12 authenticates and provides credibility for the
13 attached W-2. So it's relevant in that respect, and
14 it can come in even for that limited purpose. Other
15 than that, no, nothing else.

16 ALJ MARGOLIS: I just want to make clear that
17 I'm allowing the W-2 to come in as a business record
18 already shown, that's why I'm excluding the
19 declaration. Okay. The exhibits that I've said will
20 be admitted will be entered into the record.

21 (Respondent's Exhibits A-U, X
22 admitted into evidence.)

23 MR. POLK: For the record, I just want to
24 object to all of your overruling's.

25 ALJ MARGOLIS: Okay. That's fine. Your

1 objections are noted. Now, each side will have
2 15 minutes to make its arguments.

3 Mr. Polk, you may go first.

4 MR. POLK: Thank you. I want to raise a
5 point that's not in the briefs, but it's an important
6 point. The NPA is invalid. It should never have been
7 issued. Revenue Taxation Code 19087 authorizes an NPA
8 when the taxpayer fails to file a return.

9 In this case, FTB's Exhibit B shows that the
10 Appellant timely responded for demand for a return.
11 On page 3 and 4 of that exhibit, you can see he
12 provided a tax return. The heading on page 3, middle
13 of the page clearly says return of tax. And that
14 document means a four-part test for a valid tax return
15 established [unintelligible] number one, it purports
16 to be a return --

17 ALJ MARGOLIS: Mr. Polk, our court reporter
18 has asked me to ask you to slow down.

19 MR. POLK: We had this problem last time.
20 Sorry. Apologies already. Your fingers are going to
21 get sore.

22 Okay. Number one, it purports to be a
23 return; number two, it has sufficient data to
24 calculate the tax liability. If it is
25 [unintelligible] just let me know. It is an honest

1 and reasonable attempt to comply with law and is
2 signed under penalty of perjury.

3 The FTB ignored this return and sent a second
4 demand notice, that's Exhibit C, claiming that the
5 appellant did not file a return. And the appellant
6 replied to say he had filed a return and told FTB if
7 there's something wrong with what he had filed, to let
8 him know and he will fix it.

9 The FTB ignored this response and issued an
10 NPA. So the appellant did not fail to file a return.
11 The FTB failed to acknowledge his return and failed to
12 acknowledge Appellant's response to the second demand
13 notice offering to cure any defect in his tax return.

14 ALJ MARGOLIS: Mr. Polk, excuse me, did he
15 respond to the first demand?

16 MR. POLK: Yes, with the tax return. That is
17 Exhibit -- Exhibit D. Oh, no, I'm sorry, Exhibit B.
18 That's FTB's Exhibit B is the timely response that
19 contained the tax return. So the required conditions
20 of RTC 19087 were not met.

21 All right. Moving on, and this is going to
22 expand a bit what's on the briefs. But the
23 preponderance of the evidence shows the NPA is wrong.
24 The FTB relies on Appellant's admission that Appellant
25 received money from Space Systems/Loral, I'll call

1 them SSL, and that he received the money from City
2 Group.

3 Now, contrary to common misconception, that
4 is not sufficient factual basis to conclude that the
5 money is included by law in gross income, and
6 therefore, taxable. The FTB cannot just assume the
7 money its received is included by law in the gross
8 income.

9 As the U.S. Tax Court stated in *Lidy [sic] v.*
10 *Commissioner*, it is well-settled that the mere receipt
11 and possession of money does not by itself constitute
12 taxable income.

13 The distinction between earnings that are
14 taxable income and those that are not is recognized in
15 the Code of Federal Regulations 1.61-2, where it lists
16 several types of earnings and states that these things
17 are income to the recipients unless excluded by law.

18 The regulation does not say unless excluded
19 by a provision of subtitle A or of the code, it says
20 excluded by law. That could be an exclusion under any
21 law. How could earnings be excluded by law from
22 income? Many federal cases refer to the need to
23 connect a taxpayer to a taxable income-producing
24 activity in order to conclude there is unreported
25 gross income.

1 For example, Third Circuit in *Anastasato v.*
2 *Commissioner* stated, Given the obvious difficulties in
3 proving on a nonreceipt of income, we believe the
4 commissioner should have to provide evidence linking
5 the taxpayer to the tax-generating activities in cases
6 involving unreported income, whether legal or illegal.

7 ALJ MARGOLIS: Can you spell that case for
8 the court reporter?

9 MR. POLK: Yes. A-N-A-S-T-A-S-A-T-O,
10 *Anastasato v. Commissioner*. Also, we're going to have
11 fun with this one, Ninth Circuit in *Weimerskirch v.*
12 *Commissioner*. Do I need to spell that?
13 W-E-I-M-E-R-S-K-I-R-C-H, *Weimerskirch v. Commissioner*.

14 Ninth Circuit in that case said there must be
15 some evidentiary foundation linking the taxpayer to
16 the alleged income-producing activity.

17 So the appellant determined that perhaps the
18 evidence linking the taxpayer to the federally-taxable
19 activity, and to further clarify that point, the House
20 Congressional Record of March 27, 1943 states, The
21 income tax is therefore not tax on income as such is
22 an excised tax with respect to certain activities and
23 privileges which is measured by referring to the
24 income which they produce. The income is not the
25 subject of the tax. It is the basis for determining

1 the amount of the tax.

2 So the appellant determined that the subject
3 of the federal tax is a federally-taxable activity or
4 privilege, it is not a tax on money per say and it is
5 not a tax on everything that came in.

6 The Supreme Court in *Eisner v. Macomber*, I've
7 referenced this case in the briefs, recognized there
8 were earnings that would not qualify as taxable income
9 within the meaning of the 16th Amendment stating it
10 becomes essential to distinguish between what is and
11 what is not income as the terms that are used in that
12 16th Amendment, and to apply the distinction as cases
13 arise according to truth and substance without regard
14 to form.

15 This distinction between what is taxable and
16 what is not is recognized at 26 CFR 1.61-1, defining
17 the term gross income. And it states it means all
18 income from whatever source derived unless excluded by
19 law. The regulation does not say unless excluded by a
20 provision of subtitle A or a provision of the code.
21 It says excluded by law.

22 That could be an exclusion under any law.
23 And Exhibit 16 has been tossed, so I will just have to
24 refer to this -- to these legal authorities. But
25 Title 26 regulations, current regulations used various

1 terms to describe income.

2 It is excluded by law from gross income,
3 terms such as income holding exempt from tax under the
4 provisions of any other law. And income not taxable
5 by the Federal Government under the constitution,
6 that's in current regulations.

7 Exhibits -- well, also Treasury Decision 3146
8 refers at Article 71 to exclusions from gross income
9 of income that is, quote, by fundamental law free from
10 tax.

11 And I quote further from Article 71, quote,
12 such tax-free income should not be included in the
13 return income and need not be mentioned in the return
14 unless information regarding it is specifically called
15 for.

16 The exclusion of such income should not be
17 confused with the reduction of taxable income by the
18 application of allowable deductions, end quote.

19 How's my speed? Okay.

20 ALJ MARGOLIS: Mr. Polk, which law are you
21 saying specifically excluded it?

22 MR. POLK: Treasury Decision 3146. That's
23 what I'm citing, and I want to expand on that point.

24 ALJ MARGOLIS: 3146, that's the basis --

25 MR. POLK: Treasury Decision 3146 is what I'm

1 quoting from. The appellant determined that the money
2 he received is not included by law in gross income.
3 Despite admitting he received the money, he never
4 expressed any certainty that the money is included by
5 law in gross income, and he ultimately determined that
6 if he cannot be certain that it is included by law in
7 gross income from his reading of the law, then
8 [unintelligible] it is excluded by law from gross
9 income.

10 This is due to the well-settled rule of
11 construction established by the Supreme Court in *Gould*
12 *v. Gould*, G-O-U-L-D, where they set such statutes are
13 not taxing statutes and not to be extended by
14 implication on the clear import of the language used.
15 If the words are doubtful, the doubt must be resolved
16 against the government and in favor of the taxpayer.

17 Also, in *Spreckels Sugar Refining Company v.*
18 *McClain*, Supreme Court says the well-settled rule.
19 The citizen is exempt from taxation unless the same is
20 imposed by clear and unequivocal language, and that
21 where the construction of tax law is doubtful, the
22 doubt is to be resolved in favor of those upon whom
23 the tax is sought to be laid.

24 The appellant relied on these rules of
25 construction for taxing statutes to determine that he

1 is exempt from taxation on that money, and that he is
2 entitled by law to exclude that money from the gross
3 income on his return.

4 Per Treasury Decision 3146, a tax return does
5 not require a taxpayer to mention any money that is
6 excluded by law from gross income. And very
7 significantly in this case, the IRS has agreed with
8 these determinations and has removed the
9 previously-assessed federal tax.

10 The IRS took more than a year after the
11 appellant filed his return before they did that. It
12 might be very hard to accept that they did that, but
13 they did it. There is no basis, in fact, or law for
14 the FTB's claim that this was a mistake by the IRS.
15 This is was not a mistake. The IRS simply followed
16 the evidence and the law.

17 The federal account transcript at Exhibit X
18 on page 2, you can see that on June 5, 2017, the IRS
19 removed \$30,850 of tax based on audit reconsideration
20 after the appellant filed a return April 15, 2016. So
21 the IRS took more than a year to decide to agree with
22 Appellant's determinations. And it has been nearly
23 two years since then, and they have not changed those
24 determinations.

25 Now, the federal AGI reported on Appellant's

1 state return in Exhibit 5, which FTB claims is
2 invalid, is exactly the same amount of federal AGI
3 shown in his federal records in Exhibit X. So I don't
4 know what else he's supposed to put on his state
5 return for the federal AGI when the IRS agrees with
6 him.

7 It is obvious from federal cases such as
8 *Portillo v. Commissioner*, and in SBE and OTA cases,
9 the taxpayer's determination of his gross income on a
10 valid filed tax return is presumed correct. Cases
11 show that the FTB has been given wide latitude to rely
12 on EDD reporting and W-2 forms, but only when no valid
13 tax return has been filed.

14 The FTB claims the federal AGI on Appellant's
15 tax returns and the federal records is wrong because
16 the FTB claims the money Appellant received is
17 included by law in gross income as a jurisdictional
18 claim that the FTB is making, contrary to file tax
19 returns, and contrary to federal determination, such a
20 claim requires evidence, sufficient jurisdictional
21 facts. The FTB has not produced evidence of
22 sufficient jurisdictional facts.

23 If the FTB is correct this money is included
24 by law in gross income, then probative evidence of
25 that should be available from the third parties who

1 issued this information returns the FTB relies on.
2 But FTB did not ever contact City Group to verify
3 inflow on the 1099 or issued by City, and FTB did
4 contact Space Systems/Loral. But FTB has failed to
5 produce probative evidence as to the issue of whether
6 the money is included by law in gross income.

7 Yet, FTB has produced nothing to
8 [unintelligible] doubts as to the accuracy of the
9 legal determination represented on the W-2 form. The
10 appellant is thus entitled to a presumption against
11 the FTB.

12 Per the Appeal of *Don A. Cookston*,
13 *83-SBE-048*, the failure of a party to introduce
14 evidence that is within its control gives rise to a
15 presumption that such evidence is unfavorable to its
16 case. If such evidence existed, then they could have,
17 should have, and would have produced it.

18 If FTB is correct, they had ample opportunity
19 to obtain that evidence, but they did not. They just
20 assumed the tax return is inaccurate, they even
21 claimed without basis that the return is invalid, and
22 they assumed that the federal determinations are
23 erroneous.

24 FTB has made the same error that IRS made in
25 *Portillo v. Commissioner*. The FTB has arbitrarily

1 attributed voracity to un-verify third-party reporting
2 and assumed the taxpayer's return is false just as the
3 IRS did in *Portillo*. The federal court recognized
4 that information filed by the third parties are not
5 conclusive evidence as [unintelligible] --

6 As the district court stated in *Daines v.*
7 *Alcatel*, that's D-A-I-N-E-S, Alcatel, A-L-C-A-T-E-L,
8 the court said an informational return is filed by a
9 third party which reports income that that third party
10 believes it to be. The Internal Revenue Code makes it
11 clear that an information return is not the final word
12 on what a taxpayer's taxable income is.

13 As provided in 26 USC 6201(d), in any court
14 proceeding if a taxpayer asserts a reasonable dispute
15 with respect to any item reported on an income ratio
16 return by a third party, the IRS shall have the burden
17 of producing reasonable and probative information
18 concerning such deficiency in addition to the
19 information return.

20 The appellant's dispute of the W-2 and 1099 R
21 recording is reasonable. These forms represent legal
22 determinations that the money that was paid was
23 included by law in gross income. The appellant
24 determined that those legal determinations are
25 arbitrary and incorrect.

1 The United States District Court in *David*
2 *Nelson v. United States of America* ruled that the
3 taxpayer in that case had failed to assert a
4 reasonable dispute, quote, because the taxpayer did
5 not dispute that the remuneration he received was
6 wages and, therefore, taxable.

7 The court was clearly recognizing that a
8 dispute of a claim that remuneration received is
9 included by law in gross income and, therefore,
10 taxable --

11 ALJ MARGOLIS: Mr. Polk, you only have two
12 minutes left. But slow down.

13 MR. POLK: Oh, all right. All right. The
14 Portillo court says, quoting, *Carson v. United States*,
15 the need for tax collection does not serve to excuse
16 the government from providing some factual foundation
17 for its assessment. The tax collector's presumption
18 of correctness has a Herculean muscularity of
19 Goliath-like reach, but we strike an Achille's heel
20 when we find no muscles, no tendons, no ligaments of
21 fact.

22 The FTB has produced no ligaments of fact to
23 support its claim. Furthermore, they assume the
24 federal determinations are erroneous. Now, the FTB is
25 not bound by law to follow federal determinations, but

1 federal determinations are presumed correct when the
2 FTB bases its determinations on them, per the appeal
3 of *Willard B and Esther J Schoellerman* -- boy, lots of
4 fun names today -- S-C-H-O-E-L-L-E-R-M-A-N, that's SBE
5 September 17, 1973.

6 Now, if the previous federal determination
7 were still standing, the FTB assessment based on that
8 would be presumed correct, and the appellant would
9 have the burden to show that it's wrong. So
10 effectively, federal determinations are presumed
11 correct.

12 So now that the federal determinations
13 changed, why wouldn't those fed determinations be
14 presumed correct now, because the FTB doesn't like
15 what it says? The Federal determinations are entitled
16 to at least a rebuttable presumption of correctness.
17 The FTB is not bound by them but they cannot
18 arbitrarily disregard them.

19 They are arbitrarily disregarding them. They
20 have to have basis in fact or law to support their
21 claim that the federal determinations are erroneous
22 and they cannot prove that by just simply alleging
23 that they are erroneous.

24 ALJ MARGOLIS: Thank you. Your 15 minutes
25 are up.

1 MR. POLK: All right.

2 ALJ MARGOLIS: Mr. Amara.

3 MR. AMARA: Sure, Judge. Before I go into my
4 summary of the case, I just want to direct your office
5 to a recent U.S. Tax Court case called *Hendrickson vs.*
6 *Commissioner*. The site is T.C. Memo. 2019-10. That's
7 a February 2019 case that's directly on point with
8 this, with the issues in this case. And I'll just
9 briefly take you to a couple key portions there.

10 First of all, the litigants in that case
11 received wage at 1099 income. The approach, so to
12 speak, they took is, again, directly on point with
13 what's occurring here. They submitted -- this is page
14 480 opinion.

15 They submitted amended Form W-2s zeroing out
16 the wages reported by their employer, and they
17 submitted corrected 1099 forms as well.

18 The court, in addressing -- and then they
19 filed essentially zero returns in that case. The
20 court, when addressing what occurred there, indicated
21 its use of zero returns, zeroing out wages and
22 compensations, reporting zero liability has been
23 repeatedly characterized as frivolous. That's page 5
24 of the opinion.

25 And then further on, the court squarely

1 addressed those arguments and said the litigant's
2 tax-protestor arguments have burdened the judicial
3 system and the IRS for nearly three decades. Their
4 use of substitute Forms W-2 and, quote/end quotes,
5 corrected Forms 1099-MISC, as discussed in cracking
6 the code where this approach is laid out, and used by
7 the taxpayers in a different case, have been
8 repeatedly rejected by the court.

9 They go on to say this frivolous argument is
10 not new to the court and we will not waste judicial
11 resources addressing it further.

12 And then one other thing that's relevant to
13 this case, the litigants in that case submitted zero
14 returns or returns showing minimal income but not
15 containing the correct wage in 1099 income. The court
16 indicated the IRS is incorrect. The IRS in that case
17 incorrectly processed those returns. They indicated
18 the processing of an invalid return does not make it
19 valid. The court -- in response to that issue.

20 So I just wanted to highlight that case
21 because it's directly on point with this case. It's a
22 recent -- it's a recent opinion.

23 Now, getting to this case, as you're aware,
24 this is a 2012 case involving unreported income and
25 penalties. The reason we're here is because Appellant

1 refuses to accept this 2012 wage and 1099 income is
2 taxable and creates a filing obligation.

3 This classic frivolous argument is
4 insufficient to overturn FTB's action in this case.
5 With respect to the burden of proof here as set out in
6 FTB's briefing, the FTB's assessment is presumed to be
7 inaccurate and found to demonstrate errors unless we
8 were to prevail.

9 There are penalties in this case as well.
10 Appellant has to establish reasonable cause for
11 failure to timely file a return and/or respond to the
12 demand notices in this case -- the demand notice.

13 Now, getting to the key facts in this case,
14 it is the dispute that is relatively basic. There's
15 no real dispute Appellant received income for his
16 services with his employer in 2012, and he received
17 1099 income as well.

18 The crux of the case is in Appellant's entire
19 case rests on his semantic argument that the income he
20 received was somehow misclassified, and that it's
21 nontaxable or reportable on that basis.

22 This is an often repeated frivolous argument
23 or variations on that argument. It's been repeatedly
24 rejected by courts, both the U.S. Tax Court and
25 District Courts, the Board of Equalization and your

1 agency in the Appeal of *Holm* rejected such an
2 argument.

3 It's incontrovertible that Appellant's wage
4 in 1099 income is reportable and taxable, and it forms
5 sufficient basis for FTB's assessment. Appellant has
6 not demonstrated error in assessment so it should be
7 sustained in full.

8 With respect to the penalties in the case,
9 Appellant has not advanced any reasonable cause
10 argument against either penalty and those should be
11 sustained as well. I don't have anything further.

12 ALJ MARGOLIS: Okay. Mr. Polk, you have five
13 minutes to reply.

14 MR. POLK: Yeah. The *Hendrickson v.*
15 *Commissioner* case, I want to address that. This case
16 is off point. It's [unintelligible]. In this case,
17 the litigant Hendrickson had been convicted of filing
18 fraudulent tax return. So it was res judicata and
19 established that the returns were invalid. And that
20 makes a huge difference.

21 In this case, the IRS had accepted the
22 appellant's determination. And that makes a big
23 difference when it is settled, whether it's settled or
24 not, that the return is fraudulent or false as the FTB
25 claims.

1 I want to point out the third party's
2 reporting the FTB relies on has not been substantiated
3 in any way. The appellant actually offered positive
4 evidence for you to indicate the W-2 form SSL is not
5 reliable. He's asked SSL multiple times to verify
6 their legal determinations that they represented on
7 the original W-2, and they have refused to respond in
8 good faith.

9 See the email exchange in Exhibit 10.
10 SSL legal department flatly refused to discuss the
11 matter and refused to provide him any information.
12 See also Exhibit 13 where the appellant warns SSL that
13 their failure to produce facts and evidence to verify
14 their claims would be assumed to be their admission
15 that the information they reported on the original W-2
16 is not accurate, and that their representation of
17 gross income paid in the course of business is
18 arbitrary and without basis or fact or law. And they
19 were warned that this would be presented as evidence
20 at this hearing as a failure to respond.

21 Again, SSL refused to respond in good faith
22 making spurious claims that the information is
23 confidential. The appellant is entitled to take that
24 failure to produce evidence as an admission that their
25 determinations are arbitrary and incorrect. SSL had

1 the duty --

2 ALJ MARGOLIS: Slow down again, please.

3 MR. POLK: I'm sorry. All right.

4 The SSL had a duty to address an inquiry in
5 good faith. The U.S. Court of Appeals in Fifth
6 Circuit in *Clemens [sic] v. Revlon* found Revlon
7 negligent for failing to correct an erroneous W-2.
8 They found it was an actionable negligence.

9 The bottom line, FTB has relied on unverified
10 and unreliable third-party reporting in order to
11 assume the appellant's return is false and assume the
12 IRS determinations are incorrect. The appellant has
13 thus demonstrated error in the proposed assessment.

14 As for the frivolous appeal penalty, there is
15 nothing frivolous about saying I don't believe this
16 money is included by law in gross income as it was
17 reported by this third party. That's a legal
18 determination in terms on questions of fact.

19 It's perfectly reasonable to dispute
20 third-party reporting. The IRS and FTB both make
21 forms expressly for that purpose. There's a 3525 form
22 made by FTB and a 4852 form made by the IRS. And
23 those forms do not require the taxpayer to get the
24 third party to agree with the corrections. There is
25 no law preventing a taxpayer from issuing his own

1 corrected form so long as it reflects what people
2 leave is the correct information. The issue is
3 whether the information is correct.

4 The FTB just assumes again that the third
5 party, whatever the third party says is correct and
6 whatever is the taxpayer says is false. Well, that's
7 very self-serving of them.

8 The appellant had already filed his federal
9 return as an appeal began and was waiting for the IRS
10 to adjust his federal tax, which they did. There's
11 nothing frivolous about his position in this appeal.
12 It is supported by 26 CFR 1.61-1 and many other legal
13 authorities. His appeal of the NPA is perfectly
14 reasonable and is supported by federal determinations
15 that are in his favor.

16 If the state tax had already been assessed at
17 the time the IRS removed his federal tax in 2017, the
18 appellant would actually be required for FTB
19 Publication 1008, he would be required to contact the
20 FTB for adjustment to a state tax.

21 So there's certainly nothing improper about
22 his reliance for this appeal on his federal AGI, on
23 his federal return and the IRS determination that
24 agree with him. Therefore, there's no reasonable
25 basis for calling this appeal frivolous.

1 ALJ MARGOLIS: Okay. Do my panelists have
2 any questions of the parties?

3 ALJ KWEE: I just have one question for the
4 Franchise Tax Board. I'd like just some clarification
5 on the demand penalty.

6 Does the Franchise Tax Board's position that
7 the taxpayer did not respond at all to the demand, or
8 that the taxpayer did timely respond to the demand,
9 but provided invalid returns so the response was not
10 accepted?

11 MR. AMARA: Our position is that the response
12 was insufficient in that it didn't -- yeah, it didn't
13 constitute a return, and it didn't address the income
14 that was underlying the demand for the tax return. So
15 FTB responded to the initial response by saying,
16 please file a valid return. That's Exhibit C in the
17 record.

18 Appellant, again, failed to file a valid
19 return in response. And so the demand penalty was
20 imposed.

21 ALJ KWEE: Okay. Thank you.

22 MR. POLK: If I may interject. It is your
23 role as the board to decide whether the return was
24 valid or invalid. The FTB obviously decided it
25 wasn't. I think the case law does not support their

1 position.

2 ALJ KWEE: Thank you.

3 ALJ MARGOLIS: Okay. Is there anything
4 further from the parties?

5 MR. AMARA: Just one thing with respect to
6 the frivolous appeal penalty. I just want to direct
7 your attention to Exhibit U, page 8 of Exhibit U,
8 which was there was a prior frivolous appeal penalty
9 imposed against Appellant. And that was a 2010 case,
10 I believe, page 8 of that --

11 ALJ MARGOLIS: We're aware of that \$750
12 penalty, I believe.

13 MR. AMARA: Sure. And I just want to
14 highlight that in bold letters, in bold print at the
15 end of that summary decision, it indicates Appellant
16 should be aware we will not hesitate to impose a
17 higher penalty of statutory maximum \$5,000 per appeal
18 if he pursues further frivolous appeals.

19 ALJ MARGOLIS: Okay. Mr. Polk.

20 MR. POLK: Yeah. No question the previous
21 appeal was frivolous argument that this should not
22 prejudice him for making a valid appeal as he has done
23 in this case, and then supported by federal
24 determinations.

25 ALJ MARGOLIS: Thank you. With that, this

1 hearing is adjourned. We will take a five-minute
2 recess while we set up the next hearing. Thank you.

3 Ms. Rubalcava, what is the next hearing?

4 MS. RUBALCAVA: The next case on the agenda
5 is the appeal of Jeffrey G. Sandoval, Case ID No.
6 18043037. Appellant has indicated that he is waiving
7 appearance. Therefore, the matter is removed from the
8 agenda, and the appeal will be decided based on the
9 written record.

10 (Whereupon the proceedings were
11 adjourned at 9:55 a.m.)

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REPORTER'S CERTIFICATE

I, Amy E. Perry, a Certified Shorthand Reporter in and for the State of California, duly appointed and commissioned to administer oaths, do hereby certify:

That I am a disinterested person herein; that the foregoing hearing was reported in shorthand by me, Amy E. Perry, a duly qualified Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewritten form by means of computer-aided transcription.

I further certify that I am not of counsel or attorney for any of the parties to said hearing or in any way interested in the outcome of said hearing.

IN WITNESS WHEREOF, I have hereunto set my hand this 8th day of April, 2019.

=====

AMY E. PERRY
Certified Shorthand Reporter
License No. 11880