

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
ROBERT W. HENSE AND) OTA NO. 18073409
PAMELA M. HENSE,)
)
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) APPELLANT.)
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TRANSCRIPT OF PROCEEDINGS

Los Angeles, California

Tuesday, July 23, 2019

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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APPELLANT.

Transcript of Proceedings, taken at
355 South Grand Avenue, South Tower, 23rd Floor,
Los Angeles, California, 91401,
commencing at 10:00 a.m. and concluding
at 10:39 a.m. on Tuesday, July 23, 2019,
reported by Ernalyne M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: Hon. SARA HOSEY

Panel Members: Hon. RICHARD TAY
Hon. DANIEL CHO

For the Appellant: ROBERT HENSE
JEFFREY S. JACOBS

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD
By: DAVID KOWLACYZK
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OPENING STATEMENT

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E X H I B I T S

(Appellant's Exhibits were received at page 6.)

(Franchise Tax Board's Exhibits were received at 6.)

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Los Angeles, California; Tuesday, July 23, 2019

10:00 a.m.

ADMINISTRATIVE LAW JUDGE HOSEY: We're going on at on the record.

This is the appeal of Robert W. and Pamela M. Hense, Case Number 18073409. Today is July 23rd, 2019, approximately 10:00 o'clock. We are in Los Angeles, California. I'm lead Administrative Law Judge Sarah Hosey, and with me today are Judges Daniel Cho and Richard Tay.

Parties, can I have you state your names for the record.

MR. JACOBS: Jeffrey Jacobs, attorney for appellants.

MR. KOWLACYZK: David Kowalcyzk for respondent.

MS. MOSNIER: Marguerite Mosnier for respondent.

ADMINISTRATIVE LAW JUDGE HOSEY: Thank you.

Today's issue is whether appellants have established a basis to abate the demand penalty.

Mr. Jacobs, is that accurate?

MR. JACOBS: Yes.

ADMINISTRATIVE LAW JUDGE HOSEY: Mr. Kowalcyzk?

MR. KOWLACYZK: Yes.

ADMINISTRATIVE LAW JUDGE HOSEY: Thank you. So

1 we premarked Exhibits 1 through 12 for appellants and A
2 through AA for respondent, FTB, at the prehearing
3 conference held on July 9th, 2019.

4 Mr. Jacobs, do you have any objections to
5 admitting A through AA?

6 MR. JACOBS: No.

7 ADMINISTRATIVE LAW JUDGE HOSEY: Thank you.

8 (Department's Exhibits A-AA were received
9 in evidence by the Administrative Law Judge.)

10 ADMINISTRATIVE LAW JUDGE HOSEY: Mr. Kowalcyzk any
11 objections to admitting Exhibits 1 through 12?

12 MR. KOWLACYZK: No.

13 ADMINISTRATIVE LAW JUDGE HOSEY: Thank you.

14 (Appellant's Exhibits 1-12 were received
15 in evidence by the Administrative Law Judge.)

16 ADMINISTRATIVE LAW JUDGE HOSEY: Mr. Jacobs, do
17 you have any new exhibits today?

18 MR. JACOBS: No.

19 ADMINISTRATIVE LAW JUDGE HOSEY: Thank you.

20 Mr. Kowalcyzk?

21 MR. KOWLACYZK: No.

22 ADMINISTRATIVE LAW JUDGE HOSEY: Great. Exhibits
23 1 through 12 and A through AA are admitted as evidence
24 into the record.

25 Mr. Jacobs, are you ready for your presentation?

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MR. JACOBS: I am.

ADMINISTRATIVE LAW JUDGE HOSEY: Please begin.

OPENING STATEMENT

MR. JACOBS: So let's see what really happened here. Appellant filed a return which showed a refund of \$7,958 in 2014 and ended up costing him \$20,045 because of penalty and interest. So the issue is there reasonable cause.

Appellant was employed in the State of California 2014, while his family resided in Illinois, and he had \$88,139 withheld from state income taxes, and he was entitled to an estimated refund of \$7,958. As dated October 2nd, 2018, and indicated in respondent's opening brief page 4, appellants previously filed timely, tax returns for 2012 and 2013 as nonresidents.

However, a tax in our Respondent's Exhibits V, W, Y, and Z -- I'm not sure if Y and Z was actually -- actual exhibit was on there or not -- all referred to duplicates for the year 2013 as not filed, even though the preset was.

So my question is why are there incorrect requests for tax returns for the year 2013 in respondent's brief for 2014? Anyone who would refer to these exhibits may think the rest of the briefs and demands are subject

1 to question. By not filing and by not responding timely
2 and properly to notices and demand letters, appellant's
3 CPA and CPA tax attorney caused appellants to incur an
4 assessed delinquency penalty and a demand penalty totaling
5 \$20,045 based upon total tax liability without any
6 reduction for California withholding.

7 The form 540NR 2014 was received
8 September 1st, 2016, Respondent's Exhibit H, the final
9 notice before levy and lien, dated 9/12/2016, Exhibit G,
10 indicates a penalty code of AD. AD means failure to file
11 by the due date, and demand failure to file for a total
12 amount of \$22,835. So the failure to file by due date
13 penalty of approximately \$2,800 was abated.

14 When a penalty code A was removed from the notice
15 of state income tax dated 9/26/16, Respondent's Exhibit N,
16 it did not state any reason for the abatement of the
17 delinquency penalty file. My question is why wasn't the
18 demand failure to file penalty, penalty D, also abated at
19 that time, September 26, 2016.

20 The failure to file the return by the due date
21 and the demand failure to file penalties were caused by
22 the same inaction their CPA and CPA tax attorney. The
23 penalties were intertwined with similar facts and similar
24 tax law. Although, Mr. Hense was a nonresident when he
25 was working 2012, '13, and '14 in California, he went back

1 each weekend -- each weekend for three years,
2 approximately 150 times, to be with his wife and children,
3 especially with his son Eric.

4 Eric has a medical condition which includes
5 malformations in the interior and posterior portions of
6 the brain. Plus, neurologists are undecided if his
7 corpus -- these are all tricky words -- callosum is
8 present or his immunity is failing. It's difficult to
9 identify. His condition is present similar to cerebral
10 palsy.

11 Although appellants have never been given a
12 simple diagnosis or description, such as within months of
13 his birth were told he may never walk or talk. However,
14 over a period of 9 to 10 years, he attends school. And
15 he's had physical therapy, neuro muscular and speech
16 therapy. Eric walks, talks, plays, and attends school
17 with neuro normal children, albeit with the aid of a
18 full-time aide at all times.

19 His wife, who did not go to California to be with
20 him nor his kids -- he stayed in California -- had the
21 responsibility to take the children -- Eric, for physical
22 therapy and medical doctors. That's Exhibit 5.

23 Appellants continue to use their current
24 accounting firm, Marvin M. Siegel CPA PC, located in the
25 State of Illinois to prepare and file forms 540NR for 2012

1 and '13, which I previously stated were filed timely, and
2 then subsequently 2014 in California. Marvin Siegel CPA
3 PC is an Illinois accounting firm and has a long-term
4 relationship with appellants. The accounting firm has two
5 partners, Steven Siegel CPA and Marvin Siegel, CPA, tax
6 attorney with a master's degree in taxation.

7 Appellants felt comfortable relying on their
8 long-term representation with them, and who were familiar
9 with appellants' financial and family issues, and
10 specialized in taxation to prepare and file timely their
11 2012 and 2013 in California. Although the CPA firm was
12 located in Illinois, the CPA Firm Mobility Act allows CPA
13 firms to provide services across state lines without
14 having to register in each in which they offer these
15 services.

16 As previously stated, appellants were clients for
17 many years with the firm and trusted their expertise in
18 preparing their returns. Appellants exercised ordinary
19 business care and prudence in choosing their tax preparers
20 who they have confidence in and who they have used for
21 many years to file the 2014NR. This was neither
22 frivolous, negligent, or an illegal act.

23 However, appellants' CPA and tax attorney were
24 not familiar with the requirement to file -- timely file a
25 return in order to avoid late filing and demand penalties

1 that were being assessed on the total tax even though a
2 refund was due in the State of California. Even a tax
3 professional in the State of California never had this
4 issue could have overlooked this provision.

5 This was a substantive issue. This was not a
6 mathematical error. It was instead an erroneous
7 interpretation of the law by appellants' tax
8 professionals, which appellant reasonably relied in
9 determining whether or not they needed to file timely.
10 Also, appellants' CPA and tax attorney were not aware of
11 the requirements to respond and the consequence to
12 additional penalties and demand letters.

13 There are several cases which indicate when
14 reasonable cause comes into place. This one is a little
15 tricky of a name for me to pronounce. In Rohrbaugh versus
16 United States -- decided in United States versus Boyle, in
17 the statement thereon, both relied on taxpayer's CPA or
18 CPA tax attorney on a substantive issue and had also -- he
19 had also relied on other medical serious illness as
20 reasonable cause for hardship defense.

21 In the additional case which I submitted,
22 Repetto, indicated that if taxpayer relies on improper
23 advice of an accountant or tax attorney as a matter of tax
24 law failing to file if there were two conditions met. The
25 person relied on a tax professional with competency on the

1 subject; and two, whether the professional advice was
2 based on taxpayer's full disclosure of relevant facts and
3 documents.

4 Also in Rohrbaugh, it indicated it is not the
5 purpose of the law to penalize innocent errors made in
6 spite exercising reasonable cause. Although appellants'
7 CPA and CPA tax attorney had competency in the subject tax
8 law, taxation, and income taxes, they were not required to
9 be familiar with all the California code provisions. They
10 require the requirement to file timely tax returns in
11 California in order to avoid late filing penalties and
12 demand penalties, even though a refund was due.

13 The code provision in Illinois was different than
14 in California. Appellants' CPA and CP were also not aware
15 of the requirements to respond timely to the additional
16 penalty notice and demand letters. CPA tax attorney
17 submitted declaration of facts under perjury of law,
18 Exhibit one-one or 11, I guess. It's Exhibit 11.

19 Based upon the above court cases, appellants have
20 reasonable cause and/or undue hardship defense.
21 Appellants did not intentionally or negligently not file.
22 They reasonably relied on their CPA and CPA tax attorney
23 by substantive issue of whether or not to timely file.
24 Based upon the reasonable cause or serious illness
25 hardship, based upon son's, Eric, medical conditions, the

1 demand to file penalty should be abated and interest be
2 recomputed.

3 Thank you.

4 ADMINISTRATIVE LAW JUDGE HOSEY: All right.

5 Thank you, Mr. Jacobs.

6 Do we have any questions from the co-panel?

7 Judge Cho?

8 ADMINISTRATIVE LAW JUDGE CHO: I have no
9 questions at this time.

10 ADMINISTRATIVE LAW JUDGE HOSEY: Judge Tay?

11 ADMINISTRATIVE LAW JUDGE TAY: Mr. Jacobs, you
12 mentioned a hardship defense as grounds for reasonable
13 cause for the demand penalty. I note that the demand
14 notice question was issued January 2016. And there was a
15 deadline to respond, February 2016. Do you have any facts
16 that support the hardship defense for that time period?

17 MR. JACOBS: Well, it's the same all the way
18 through. I mean he was moving -- going back and forth
19 during those periods of time, and it was still a hardship.
20 It was indicated also in the declarations that the CPA and
21 tax attorney did get the documents, notices, and did not
22 respond.

23 So they have been relying on them for many years.
24 Prior to even 2012 they were clients. And these are
25 clients who had, you know, sufficient knowledge what they

1 should do and not do.

2 ADMINISTRATIVE LAW JUDGE TAY: Thank you.

3 MR. JACOBS: You're welcome.

4 ADMINISTRATIVE LAW JUDGE TAY: In regards to the
5 reliance on the CPA tax attorney, do you have any evidence
6 of specific advice that your clients received with regard
7 to the response, any kind of response to --

8 MR. JACOBS: So I did -- I did send an e-mail in
9 that talked about it. But, basically, what happened was
10 that Mr. Hence was in California working and all that
11 stuff. And the accountants and tax attorney said, "Look,
12 we believe there is not going to be any penalties, and,
13 therefore, we don't have to file timely, which was wrong.
14 This was wrong, you know. They made a mistake. They
15 weren't right.

16 Therefore, they didn't proceed in gathering all
17 the information they could have gotten because they did
18 file timely in 2012 and 2013. So sometimes -- well, first
19 of all, they didn't keep good records either because there
20 was no documentation on that when I asked them for it.
21 They said, "No, we never discussed it with them."

22 So sometimes no documentation is the best
23 documentation. They didn't converse with him. They
24 didn't keep him abreast. They were wrong in the analysis
25 of filing the tax return. It was a mess.

1 ADMINISTRATIVE LAW JUDGE TAY: Okay. And just to
2 clarify when you say they didn't need to file, did that
3 include not needing to respond in any other way to the
4 notice?

5 MR. JACOBS: Well, first of all, the notices
6 would come, and they would also come to the attorney and
7 CPA. They didn't respond to them. So they did not
8 realize how important it was. And taxpayers, appellants,
9 they relied -- I mean, they weren't involved in this.
10 They gave them all the information to file 2012 and '13,
11 even though they indicate that those records that I was
12 mentioning said they weren't filed. 2013 wasn't filed
13 timely.

14 Those documents are very difficult to read, even
15 if somebody were to read them. They would have to know
16 what the A means. You have to do what the D means. You
17 have to do this. You have to do that. I'm not making
18 excuses. I'm just saying that based upon the stress of
19 being away and having to deal with the situation at home,
20 the appellants did not look at the notices. The CPA
21 attorneys did or did not look at the notices. They didn't
22 respond appropriately. So that's all.

23 ADMINISTRATIVE LAW JUDGE TAY: Thank you. Just
24 last point ever clarification when you said they didn't
25 discuss it, do you mean that -- that your clients did not

1 discuss the notices at all with the CPA?

2 MR. JACOBS: Well, the CPA got the notices. The
3 CPA got the notices. They should have responded properly.
4 It's the same issue. First of all, this issue wouldn't
5 have occurred if it would have been filed timely.
6 Everything starts at the top. They didn't file timely.
7 They got penalized. They got a delinquency of penalty.
8 That was abated. Why was that abated? There's no record
9 of why it was abated.

10 And then after that, they filed a tax return and
11 they started -- and they continued to get demand notices,
12 and those weren't responded to. Like I said, why wasn't
13 the demand abated at the same time. It's all the same
14 issue. If they would have filed timely, he would have
15 gotten his refund. He would have no penalties. Because
16 of non-filing he's getting demand notices which weren't
17 responded to properly. And then taxpayers, appellants,
18 kept believing in their accountants.

19 It's all one thing. It started at the top, went
20 down. It's all the same issue.

21 ADMINISTRATIVE LAW JUDGE TAY: Thank you.

22 MR. JACOBS: You're welcome.

23 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. Thank
24 you.

25 Mr. Kowalczyk, I'm probably jumping ahead here a

1 little, but since Mr. Jacobs brought up the abatement of
2 the delinquent penalty, which we discussed at the
3 prehearing conference, can you explain the reasoning for
4 the abatement, FTB's abatement of the delinquent penalty?

5 MR. KOWLACYZK: Yes.

6 ADMINISTRATIVE LAW JUDGE HOSEY: Okay.

7 MR. KOWLACYZK: So because the taxpayers did not
8 file a 2014 tax return on time, respondent imposed a
9 delinquent filing penalty. However, once we receive their
10 tax return, the tax return showed that they were owed a
11 refund because they had sufficient tax payments.

12 So the way the demand -- the delinquent filing
13 penalty works is that in the calculation of it, if there
14 are sufficient tax payments, those are taken into account
15 when determining how much of the delinquent filing penalty
16 will be imposed. In this case because they had sufficient
17 tax payments to satisfy their tax liability, the
18 delinquent filing penalty would have effectively been
19 calculated at zero. And that's why the delinquent filing
20 penalty was made.

21 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. Thank
22 you. If you would like to begin your presentation as
23 well, please -- sorry. I probably messed you up a little
24 bit, but please proceed.

25 MR. KOWLACYZK: Thank you.

OPENING STATEMENT

1
2 MR. KOWLACYZK: Good morning. The issue before
3 us today is whether appellants have met their burden of
4 proof to establish reasonable cause to abate the demand
5 penalty for tax year 2014. To establish reasonable cause,
6 appellants must show their failure to reply to the demand
7 for tax return occurred despite exercise of ordinary care
8 and business prudence.

9 Appellants argue they established reasonable
10 cause to abate the demand penalty because they relied on
11 the advice stating they did not have to file a timely tax
12 return when they were due a refund. However, this
13 argument fails because ordinary care and business prudence
14 require appellants to timely reply to the demand and
15 explain why they were not required to file a tax return.

16 Appellants had a non-delible duty to respond to
17 the demand notice. In addition, appellants' argument that
18 they didn't have to reply to the demand because they had
19 sufficient tax payments to satisfy their tax liability
20 also does not constitute reasonable cause. Appellants
21 also argue they established reasonable cause because
22 appellant, husband, spent the majority of his time
23 traveling to and from Illinois to California for work.

24 However, workplace pressures do not constitute
25 reasonable cause, and appellant, husband, quit his job

1 approximately one year before respondent issued the demand
2 for tax return. Finally, appellants argue they
3 established reasonable cause to abate the demand penalty
4 because they have a child with physical disabilities.
5 However, this argument also failed because appellants have
6 not explained how having a child with physical
7 disabilities continuously prevented them from responding
8 to the demand notice.

9 As stated in the appeal of Haliburka (phonetic),
10 medical conditions do not constitute reasonable cause
11 unless the taxpayers were continuously prevented from
12 responding to the demand notice. The only explanation
13 appellants provided for why they did not respond to the
14 demand notice, was because the demand notice was either
15 misplaced or thrown out, which are both not reasonable
16 cause.

17 Accordingly, appellants have not met their burden
18 of proof to establish reasonable cause, and for the
19 Franchise Tax Board, action must be sustained.

20 Thank you.

21 ADMINISTRATIVE LAW JUDGE HOSEY: Thank you. Do I
22 have any questions from the panel?

23 Judge Cho?

24 ADMINISTRATIVE LAW JUDGE CHO: Yeah. Just a
25 couple of quick clarifying questions. In earlier

1 presentation by Mr. Jacobs, he was saying how the
2 appellants have timely filed their 2013 tax returns, but
3 it looks like FTB's position is that those tax returns
4 were not timely filed. Can I just get your response to
5 that?

6 MR. KOWLACYZK: Yes. So respondent issued a
7 request for tax return on April 22nd, 2015, for the 2013
8 year, and that's Respondent's Exhibit V. And also in
9 Respondent's Exhibit W, we issued a Notice of Proposed
10 Assessment when they did not file a tax return in response
11 for the request for tax return.

12 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you.

13 Mr. Jacobs, do you have a response to that?

14 MR. JACOBS: Yes. It was filed timely. It was
15 filed timely.

16 ADMINISTRATIVE LAW JUDGE CHO: Do you have any
17 evidence to support your statement?

18 MR. JACOBS: Yeah. In the respondent's opening
19 brief, page 4, it says, "Appellants previously filed
20 timely California returns for 2012 and '13 as
21 nonresidents." It's in the middle.

22 ADMINISTRATIVE LAW JUDGE CHO: One second. I'm
23 sorry.

24 MR. KOWLACYZK: Can I clarify the statement? It
25 says in -- appellants representative stated that.

1 ADMINISTRATIVE LAW JUDGE CHO: I see.

2 MR. KOWLACYZK: Yes.

3 MR. JACOBS: I'm not sure what that says. It's
4 clear to me that it says --

5 ADMINISTRATIVE LAW JUDGE CHO: So it looks like
6 FTB is just repeating your arguments in their brief.

7 MR. JACOBS: I don't think so.

8 ADMINISTRATIVE LAW JUDGE CHO: So other than this
9 document, do you have anything else --

10 MR. JACOBS: No.

11 ADMINISTRATIVE LAW JUDGE CHO: -- to kind of
12 support that?

13 MR. JACOBS: No. And I -- I have -- they would
14 have to have the records to show if there was a penalty
15 assessed or not.

16 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you.

17 And then another quick question for Mr. Kowalczyk
18 is the calculation of the penalties. So from what I
19 understand FTB's position is that the delinquent filing
20 penalties measured off of the tax owed. And the demand
21 penalty, what is that measured off of?

22 MR. KOWLACYZK: So the demand penalty is
23 calculated based on the amount of tax that's required to
24 be shown on the tax return without taking into account
25 timely payment.

1 ADMINISTRATIVE LAW JUDGE CHO: Okay. So is that
2 the difference between Section 19131 and 19133?

3 MR. KOWLACYZK: Correct.

4 ADMINISTRATIVE LAW JUDGE CHO: Okay. Did you
5 understand that, Mr. Jacobs?

6 MR. JACOBS: Yes. But my argument is, as I said
7 before, there would be no demand penalty if it was filed
8 timely. So the whole issue is a reliance on the attorney
9 and the CPA. It's one issue. One issue continuing
10 through the whole mess, that if you would have filed
11 timely based upon the attorneys and tax reps, you know,
12 the right way to do it, there would be no penalty. And
13 there would be no notices.

14 ADMINISTRATIVE LAW JUDGE CHO: Okay. Thank you.
15 That's all questions I had.

16 MR. JACOBS: So, basically, I'm saying is, there
17 was a reasonable cause not to file. And there was
18 reasonable cause to abate the demand penalties also
19 because it's all one issue.

20 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. Thank
21 you.

22 Judge Tay?

23 ADMINISTRATIVE LAW JUDGE TAY: Mr. Kowalczyk, to
24 the question of reasonable reliance on the tax
25 professional, I note that in your brief you cite U.S.

1 versus Boyle. I also note that's -- that addresses the
2 late filing penalty. Are there -- do you have any other
3 cases that would apply the same standards to finding a
4 reasonable cause to the demand penalty?

5 MR. KOWLACYZK: Not in particular. But in this
6 case, Boyle does not apply because the taxpayer, as
7 appellants' representative has stated, the taxpayers did
8 not receive advice regarding how to respond to the demand.
9 And the only time they did receive advice, was about 9
10 months before respondent issued the demand notice. And
11 that was in regards to how -- if they needed to file a
12 return from the original due date.

13 ADMINISTRATIVE LAW JUDGE TAY: You mean
14 nonspecific written advice on the -- whether or not
15 there's a requirement to respond to the demand or -- what
16 do you mean by advice?

17 MR. KOWLACYZK: They did not receive tax advice
18 on whether they needed to respond to the demand notice.

19 ADMINISTRATIVE LAW JUDGE TAY: The Boyle is --
20 kind of holding in Boyle is really more about the fact
21 that there was a deadline, and the deadline is not really
22 tax advice at all.

23 MR. KOWLACYZK: Yes. That -- that is true. And
24 Boyle also stands for the proposition that taxpayers do
25 not have -- or have a non-delible duty to timely file

1 their tax return. And in Boyle, the taxpayers relied on
2 their CPA to file a tax return. And in that case, that
3 does not constitute reasonable cause. But if they did
4 receive advice as to a matter of tax, then it could be
5 considered reasonable cause.

6 ADMINISTRATIVE LAW JUDGE TAY: If we were to find
7 that there was advice about whether or not to -- there was
8 a filing -- a response requirement overall, would that be
9 substantive tax advice?

10 MR. KOWLACYZK: No. That would not be tax advice
11 because it does not get to the issue of whether there
12 needed to be a legal interpretation or a legal opinion.
13 It's just merely following a deadline.

14 ADMINISTRATIVE LAW JUDGE TAY: So you're saying
15 that if the taxpayer received advice from their attorney
16 saying you don't have to file because you're -- you paid
17 enough and you're an Illinois resident, that's not
18 substantive tax advice? Is that what you are saying?

19 MR. KOWLACYZK: Yes. That would not be
20 substantive tax advice because that's merely a calculation
21 of the amount of tax due, and it's not a matter of
22 California tax law. If the attorney would say that
23 because of a certain provision in the tax code, such as
24 whether they were a non -- whether it would be -- they
25 could be considered a resident or nonresident.

1 Then that might be considered substantive tax
2 advice, but in this case that would be merely a
3 calculation of the tax due. And it doesn't really require
4 a legal opinion to determine whether they would need to
5 file.

6 ADMINISTRATIVE LAW JUDGE TAY: I see you're
7 making the distinction between a mathematical
8 calculation -- excuse me -- as to whether tax is due
9 versus whether or not they have a requirement to respond
10 to the notice. That's the distinction that you're making?

11 MR. KOWLACYZK: Yes.

12 ADMINISTRATIVE LAW JUDGE TAY: Okay. Okay. No
13 further questions on that.

14 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. I'm going
15 to bring up something a little different. As we were
16 preparing for this hearing, we started talking about
17 Subsection (b) of 19133, specifically (b)(2). (B)(1)
18 requires for the application of demand penalty whether the
19 taxpayer fails to respond to the current demand for tax,
20 which we have -- we're discussing now.

21 But (b)(2) also requires FTB to propose an
22 assessment of tax after the taxpayer fails to timely
23 respond to a demand at any time during the taxable year
24 period preceding the taxable year, which is 2014. And we
25 were kind of discussing that language and what it means.

1 And I know we haven't -- we didn't bring this up
2 in the prehearing conference, or it really wasn't ferreted
3 out in the briefing. So if you would like to respond,
4 you're more than welcome to. But I'm thinking what I'll
5 do is have a post-hearing briefing on that specific other
6 issue. And I will issue an order kind of explaining what
7 I would like to -- or what we as a panel would like to
8 hear about that subsection.

9 Mr. Kowalczyk, if you would like to make a
10 statement, you're more than welcome to. But I do believe
11 I'm going to give each party a chance to brief it after
12 the hearing today.

13 MR. KOWLACYZK: I will make a quick statement
14 about that issue, if that's all right?

15 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. Yeah.
16 Please.

17 MR. KOWLACYZK: So literally reading of
18 regulation 19133 Subdivision (b)(2), provides that the
19 demand penalties are properly imposed when the notice of
20 proposed assessment is issued during 4-year taxable period
21 prior to the taxable year in the demand penalty.

22 However, Subdivision (d) of example 2 shows the
23 demand penalty is properly imposed when the notice of
24 proposed assessment is issued for one of the previous
25 calendar years. The United States Supreme Court and the

1 California Courts of Appeal have explained that when
2 interpreting a regulation, every word and phrase in the
3 regulation must have meaning and the regulation as a whole
4 must be read as a whole so that all parts are given
5 effect.

6 If there's an ambiguity on the regulation, then
7 the court is to the agency's interpretation of its own
8 regulation. In this case, regulation 19133, is clearly
9 ambiguous on when the demand penalty is properly imposed
10 because Subdivision (d) is inconsistent with subdivision
11 (b)(2).

12 Respondent contends in regulation 191334 should
13 be interpreted similarly to Subdivision (d), and that the
14 demand penalty is properly imposed when the notice of
15 proposed assessment is issued for one of the previous four
16 calendar years.

17 This -- this interpretation is consistent with
18 the history of the regulation. Initially the California
19 legislature confer discretionary authority on respondent
20 to assess the demand penalty whenever a taxpayer failed to
21 file a return upon notice and demand. And respondent
22 assess the demand penalty on any non-filer.

23 In response to public concern, the three-member
24 board adopted policy to only impose the demand penalty on
25 only repeat non-filers who had not filed a tax return in

1 response to the demand notice on one of the previous four
2 calendar years. Respondent subsequently formally adopted
3 this policy in regulation 19133, and the examples in
4 Subdivision (d) show when the demand penalty will be
5 imposed. Therefore, the panel should defer to
6 respondent's interpretation of when -- the regulation on
7 when the demand penalty should be imposed.

8 Thank you.

9 ADMINISTRATIVE LAW JUDGE HOSEY: Okay.

10 Mr. Jacobs, I know that lists a lot. So what I'm going to
11 do is I'm going to have FTB do their post-hearing brief
12 first. I'll give you 30 days, since it seems like you
13 have a good grasp on how you want to interpret that
14 subsection.

15 And then Mr. Jacobs, you'll have 30 days to
16 respond.

17 Then we will close the record at that point and
18 then confer and issue a decision after that. So we're not
19 ready to submit the case today. The record will remain
20 open for the parties to address this 19133 Subsection
21 (b)(2) requirement. I will issue an order laying out what
22 should be discussed in the deadlines.

23 But just a heads up, 30 days from today is
24 August 23d. So I foresee that being Mr. Kowalczyk's
25 deadline, and then 30 days after that is September 27th,

1 Mr. Jacobs. So I'll issue an order laying out these
2 deadlines, and we will go from there. I appreciate you
3 guys and your time today on this. I know there's a lot to
4 unpack, but the hearing is now adjourned.

5 MR. JACOBS: Wait. Can I have a rebuttal?

6 ADMINISTRATIVE LAW JUDGE HOSEY: Oh, I'm so
7 sorry, Mr. Jacobs. Yes, you do have an opportunity for
8 rebuttal.

9 MR. JACOBS: Right. And it's a good one.

10 ADMINISTRATIVE LAW JUDGE HOSEY: Okay. Let's
11 hear it.

12 MR. JACOBS: So I'm going to respond to what he
13 said.

14 ADMINISTRATIVE LAW JUDGE HOSEY: Please.

15 MR. JACOBS: There was a lot of information he
16 gave us, and it seems to me that it's substantive issues,
17 what he's talking about. And of course, one of my things
18 is a reliable -- reasonable cause based on substantive
19 issue. That is definitely a substantive issue. So I
20 think I'm going to be in good hands with my response.

21 The second thing is, yes, both appellants and
22 respondents are relying on the same cases and the same
23 facts for reasonable cause. One thing, however, that is
24 very, very important is in this terrific case, Rohrbaugh.
25 I don't know if I'm pronouncing it right or not. It is

1 specifically stated, "It is not the purpose of the law to
2 penalize innocent errors made despite the exercise of
3 reasonable care."

4 Taxpayers, appellants, used reasonable cause.
5 They relied on their representatives who are knowledgeable
6 on taxation to file a tax return. That's a substantive
7 issue. It is not a mathematical issue. Whether or not
8 you have to file timely is in issue in the code, and it
9 says you have to file by a certain date. If they made a
10 decision not to file by a certain date, it's an issue of
11 law, substantive issue.

12 Thank you.

13 ADMINISTRATIVE LAW JUDGE HOSEY: Yes, thank you.

14 Okay. As I stated before, we're not submitting
15 the case today. We're going to leave the record open. I
16 will issue the order laying out what we'd like to see
17 discussed about the 19133(b)(2) issue. And will layout
18 the deadline for each party again just so it's clear.

19 Again, thank you for your time today.

20 MR. JACOBS: Thank you.

21 ADMINISTRATIVE LAW JUDGE HOSEY: And now the
22 hearing is adjourned.

23 (Proceedings adjourned at 10:39 a.m.)
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HEARING REPORTER'S CERTIFICATE

I, Ernalyln M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 13th day of August, 2019.

ERNALYN M. ALONZO
HEARING REPORTER