

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
ROBERT D. TAYLOR and ) OTA NO. 18093829  
JOY JOHNSON TAYLOR, )  
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 )  
 ) APPELLANT. )  
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Thursday, July 23, 2020

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Suite 300, Cerritos,  
California, 90703, commencing at 2:19 p.m.  
and concluding at 3:30 p.m. on Thursday,  
July 23, 2020, reported by Ernalyn M. Alonzo,  
Hearing Reporter, in and for the State  
of California.

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APPEARANCES:

Panel Lead: ALJ JOHN JOHNSON

Panel Members: ALJ RICHARD TAY  
ALJ CHERYL AKIN

For the Appellant: ROBERT TAYLOR  
LYDIA B. TURANCHIK

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
By: BRAD COUTINHO  
MARIA BROSTERHOUS

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-6 were received at page 7.)  
(Department's Exhibits A-S were received at page 7.)

OPENING STATEMENT

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1 Cerritos, California; Thursday, July 23, 2020

2 2:19 p.m.

3

4 JUDGE JOHNSON: With that, we're going on the  
5 record.

6 This is the appeal of Taylor. It is OTA Case  
7 Number 18093829. It is 2:19 on July 23rd, 2020.

8 This appeal is being conducted electronically  
9 lead by myself here in sunny Sacramento, California. I'm  
10 the lead ALJ for this hearing, Judge John O. Johnson. And  
11 let me say good afternoon to my fellow co-panelists today.

12 Good afternoon, Judge Akin.

13 JUDGE AKIN: Good afternoon. Judge Akin here.

14 JUDGE JOHNSON: And good afternoon, Judge Tay.

15 JUDGE TAY: Good afternoon. Judge Tay here.

16 JUDGE JOHNSON: Thank you.

17 And let me have the parties introduce themselves  
18 since we're here. We'll start with the Appellants.

19 MS. TURANCHIK: I am counsel for the Appellants  
20 Lydia Turanchik.

21 MR. TAYLOR: I am Robert Taylor, the Appellant --

22 JUDGE JOHNSON: Thank you.

23 MR. TAYLOR: -- along with my wife, Joy.

24 JUDGE JOHNSON: Thank you very much.

25 And Respondent, Franchise Tax Board, if you could

1 please introduce yourselves.

2 MR. COUTINHO: This is Brad Coutinho for the  
3 Franchise Tax Board.

4 MS. BROSTERHOUS: And Maria Brosterhous for the  
5 Franchise Tax Board.

6 JUDGE JOHNSON: Thank you.

7 Just a reminder that while I am the lead for  
8 purposes of conducting this hearing, the panel of three  
9 judges will make the decision. Our decision is going to  
10 be based on the arguments and evidence provided by the  
11 parties on appeal in conjunction with the appropriate  
12 application of law, as well as any testimony and arguments  
13 provided today at the hearing.

14 We have read the briefs, examined the exhibits,  
15 and are looking forward to what you have to give us today.  
16 We fully respect the importance of the decision to be made  
17 on this appeal, and we know it's taken many steps to get  
18 to this point.

19 The issues we have on appeal are whether  
20 Appellants have shown reasonable cause to abate the late  
21 payment of tax penalty imposed under R&TC Section 19132;  
22 and whether Appellants have established that the  
23 underpayment of estimated tax penalty imposed under R&TC,  
24 Section 19136 should be abated.

25 Appellants have provided Exhibits 1 through 6,

1 and the Franchise Tax Board has provided Exhibits A  
2 through S. Those will be admitted into the record without  
3 objection.

4 (Appellant's Exhibits 1-6 were received  
5 in evidence by the Administrative Law Judge.)

6 (Department's Exhibits A-S were received in  
7 evidence by the Administrative Law Judge.)

8 Next, we'll begin with the parties' opening  
9 statements.

10 Ms. Turanchik, are you ready to provide your  
11 opening statement for Appellant?

12 MS. TURANCHIK: I am. Thank you, Your Honor.

13 JUDGE JOHNSON: Okay. You may proceed when  
14 you're ready.

15

16 OPENING STATEMENT

17 MS. TURANCHIK: My name is Lydia Turanchik. I am  
18 counsel for the Appellants, Robert and Joy Taylor. What  
19 are we really arguing about here? Primarily, the FTB  
20 wants to impose a penalty on Mr. Taylor's failure to pay  
21 his taxes timely, pay taxes associated with allocated  
22 income, that was either unknown nor foreseeable by  
23 April 15th, 2017, and for many months thereafter.

24 We believe Mr. Taylor had reasonable cause for  
25 the failure to make its timely tax payment with respect to

1 allocation of additional income 20 times what was reported  
2 for the previous 4 years, which could not have been known  
3 to the taxpayer prior to April 15th, 2017.

4 This whole case boils down to the FTB's belief  
5 that the taxpayer, Mr. Taylor, knew or should have known  
6 that this massive income increase was looming for 2016.  
7 While we believe as a matter of law that the FTB is  
8 incorrect in its analysis in this issue, Mr. Taylor's  
9 testimony is critical and will establish that the FTB's  
10 factual arguments in this case are erroneous as well.

11 Mr. Taylor will explain why, in early 2017, there  
12 was absolutely no possible way that he knew or should have  
13 known that there was an additional income allocation  
14 looming for the 2016 year. Mr. Taylor will explain that  
15 the income did not flow from an actual tangible event in  
16 2016, but rather what was, effectively, an accounting  
17 adjustment made in 2017.

18 We will also explain how the relationship between  
19 his company Centinela, and the fund was in shambles as a  
20 result of ongoing litigation. And the fund was not ever  
21 going to provide any information to Mr. Taylor or  
22 Centinela that was not required by the time frames  
23 contained in the LLC agreements.

24 Finally, Mr. Taylor will testify that even if the  
25 documents could have been made available to investors on



1 or before April 15 were actually made available, there  
2 would have been no indication in those records of any  
3 income adjustments to be made for 2016. Put simply, prior  
4 to April 15, 2017, Mr. Taylor did not know, nor did he  
5 have reason to know nor could he have known of the  
6 significant income adjustment looming on the horizon for  
7 2016.

8 The FTB's position on this matter is without  
9 merit, and Mr. Taylor had reasonable cause for his failure  
10 to pay timely the tax obligation ultimately determined to  
11 be due for the 2016 year. The FTB also wants to impose an  
12 estimated tax penalty for the same year. While we  
13 recognize that the estimated tax penalty is not subject to  
14 the same reasonable cause exception, it is subject to  
15 waiver where, as here, an underpayment is due to a limited  
16 and unusual circumstance where it would also deny equity  
17 in good conscious to impose the penalty. Here the same  
18 facts that require a finding of reasonable cause mandate a  
19 finding that the estimated tax penalty must also be  
20 waived.

21 Thank you.

22 JUDGE JOHNSON: This is Judge Johnson. Thank  
23 you.

24 And Mr. Coutinho, would Franchise Tax Board  
25 provide an opening statement?

1           MR. COUTINHO: This is Brad Coutinho. Franchise  
2 Tax Board will not be making an opening statement. We  
3 will reserve it for our argument --

4           JUDGE JOHNSON: I think the audio cut there a  
5 little bit, Mr. Coutinho. But could you repeat that,  
6 please.

7           MR. COUTINHO: Yes. I apologize. Franchise Tax  
8 Board will not be making an opening statement. We'll  
9 reserve out argument for the argument section.

10          JUDGE JOHNSON: Okay. Thank you. This is  
11 Judge Johnson again.

12          With that, we're ready to go into Mr. Taylor's  
13 testimony. Appellants, are you ready to provide that  
14 testimony?

15          MS. TURANCHIK: This is Lydia Turanchik. Yes, we  
16 are, Your Honor.

17          JUDGE JOHNSON: In that case I'll swear you in,  
18 Mr. Taylor. Would you please raise your right hand.

19

20

ROBERT TAYLOR,

21 produced as a witness, and having been first duly sworn by  
22 the Administrative Law Judge, was examined and testified  
23 as follows:

24

25

JUDGE JOHNSON: Thank you.

1 Ms. Turanchik, you may begin.

2 MS. TURANCHIK: Thank you. This is Lydia  
3 Turanchik.

4

5

DIRECT EXAMINATION

6

BY MS. TURANCHIK:

7

Q Good afternoon, Robert. How are you doing there?

8

A I'm doing okay.

9

Q We've got about 20 minutes, so we need to move  
10 through this somewhat quickly. Let's first talk about  
11 your education history. Can you just briefly state what  
12 your education is?

13

A I am a graduate of North Hollywood High School,  
14 California State University Northridge, with a degree in  
15 engineering, and the Stanford Law School and Stanford  
16 Business School.

17

Q And when did you graduate from Stanford Business  
18 School?

19

A I did a joint JD and MBA program completing both  
20 degrees in 1986.

21

Q Okay. Could you just briefly describe your work  
22 history prior to joining the entity that is sort of an  
23 issue here in Centinela?

24

A Upon leaving graduate school, I went to work for  
25 McKinsey & Company. I was there between approximately

1 1986 and 1997. In 1997, along with three other partners,  
2 we co-founded a lower-middle market buyout firm called  
3 Blue Capital. In 2006, I co-founded Centinela Capital  
4 with three different partners.

5 Q Could you just briefly describe your work  
6 experience at both McKinsey and then at Blue Capital?

7 A At McKinsey & Company I was a general management  
8 consultant. I did strategy operations and organization  
9 work for a variety of Fortune 500 companies, mostly here  
10 in North America. And with Blue Capital.

11 With Blue Capital, Blue Capital was a  
12 lower-middle market buyout fund. It was a co-investor and  
13 control takeout of, again, lower-middle market companies  
14 generally roughly defined as less than \$500 billion in  
15 revenue invested in, I want to say, eight platform  
16 investments in that period. Blue Capital unfortunately  
17 came to an end or at least was a dealt mortal blow on  
18 9/11.

19 We had several companies facing --  
20 consumer-facing companies. And if you recall that period,  
21 in 2001 we had a very sharp but brief recession that  
22 followed 9/11. And even more tragically, we lost a  
23 partner that day. It also turns out one of my surviving  
24 partners was born on 9/11.

25 So it was a pretty tragic day for us, and it

1 spelled the end of that firm. It did -- private equity is  
2 a long-tail investment strategy. So it took some time to  
3 wind that down and then to start my next firm, which is  
4 Centinela Capital.

5 Q Okay. So let's focus on Centinela. What was its  
6 primary business? What did it do?

7 A Centinela Capital was a fund of funds; a fund of  
8 funds -- a private equity fund of funds. It is one of the  
9 vehicles that would invest in a firm like Blue Capital.  
10 So Centinela Capital invested about a billion dollars in  
11 46 firms around the country in a variety of private equity  
12 strategies. Those strategies range from buyouts, as would  
13 have been the case of Centinela. That was at Blue  
14 Capital, and that was its strategy -- I apologize. I tend  
15 to speak fast. I will slow down -- as well as Venture --  
16 Venture Capital and debt strategies, special situation  
17 strategies.

18 The challenge or the particular focus for  
19 Centinela Capital was to invest in what are known as  
20 emerging or in some parlance, as emerging managers. These  
21 are first time funds as Blue Capital was. First and  
22 second time funds -- folks new to the industry with an eye  
23 towards making attractive risk adjusted returns, number  
24 one, as well as diversify the GP base.

25 Q And are you familiar with the funds at issue here

1 Capital Links funds I and II?

2 A Yes, ma'am. Capital Link Funds I and -- sorry.

3 Q Can you explain Centinela's role in Capital Link  
4 Funds I and II?

5 A Capital Link Funds I and II were the funds  
6 invested by Centinela Capital. They were each  
7 approximately \$500 million dollars in capitalization.  
8 CalPERS was the sole outside investor. Capital Link I was  
9 closed, and operation lies in 2007. Capital Link II was  
10 closed and operation lies in 2008; both with the mandate  
11 that I just described in terms of investing emerging  
12 managers seeking attractive risk-adjusted returns,  
13 diversifying the GP base.

14 Each of them invested in about 25 underlying GPs,  
15 again, in the strategies I described. There was some  
16 overlap between the firms, which is why the total doesn't  
17 sum to 50, instead it's more like 46. And just for the  
18 record, each one of those firms in turn would have  
19 deployed their capital. Average investment was about  
20 \$10 thousand -- \$10 million if you took the billion  
21 dollars and divided it. You sort of get that kind of  
22 money.

23 And they would in turn invest in a variety --  
24 they had other investors. We would have been no more than  
25 10 percent in any one fund -- firm, and they would invest

1 anymore from 7 or 12, on average about 10 portfolio  
2 companies.

3 Q And at some point in time, did you become the  
4 fund manager for Centinela -- I'm sorry -- for risk  
5 Capital Link Funds I and II?

6 A From its inception Centinela was founded on  
7 winning an RFP for Capital Link I. So we were the  
8 original manager off Capital Link I. The success with  
9 Capital Link I led to being awarded Capital Link II  
10 without competition.

11 Q And did there come a time when you were removed  
12 as fund manager?

13 A Yes. In 2012 we were notified that we were being  
14 terminated under the No-Fault Termination provision that  
15 exist in each of the Capital Link Funds operating  
16 documents. That was on July 10th, 2012. It became  
17 effective October 10th, 2012.

18 Q And what was the reason for that?

19 A It was a No-Fault Termination. No reason was  
20 required. Our belief is that it was a result of our  
21 having filed an administrative proceeding, which is  
22 precursor to filing a civil suit required in State of  
23 California, a year earlier. CalPERS the sole investor in  
24 the fund, our client, believed that one of my partners was  
25 involved in what was known as the "Placement Agent"

1 scandal and asked us to fire him.

2 We ultimately reached a -- and they told us in  
3 exchange for firing him, they would invest another \$100  
4 million with Centinela Capital.

5 And I apologize. My doorbell ringing thing works  
6 in here. You're going to hear Alexa speak in a moment,  
7 and I'm going to step over here and cut her off. While  
8 this is a public matter, I don't want Amazon to know  
9 everything.

10 They believed that my partner -- one of my  
11 partners was involved in that placement agent scandal.  
12 The placement agent scandal essentially was pay to play.  
13 Others might know it as where folks with relationships  
14 with CalPERS were selling those relationships, which  
15 ultimately led to investment. There was belief, again,  
16 one of my partners had that kind of relationship. They  
17 basically asked us to prove a negative that he did not  
18 have that relationship. We could not do that after six  
19 months of effort.

20 Instead they said, look, if you separate with  
21 him, we will give you this \$100 million mandate. We did  
22 reach an agreement with my partner to separate. And  
23 instead of giving us the mandate, they fired it -- or  
24 excuse me. They -- they decided to bid the business, and  
25 then they eliminated us from the bid and never delivered



1 on that -- the promise on the contract that we had agreed  
2 that that would be the deal. So we sued them for --

3 Q So from 2006 -- I'm sorry -- from 2012 through  
4 the year at issue here in 2016, you were involved in an  
5 active litigation with the fund -- with the fund manager,  
6 with CalPERS?

7 A Active litigation through January of this year.

8 Q After your removal as manager, what was your role  
9 with Capital Link Funds? In other words,  
10 post-October 2012 what role did you have with Link -- I'm  
11 sorry -- with Capital Link Funds?

12 A We had no active role. By definition of the  
13 contract, we became a passive non-voting member in the  
14 LLCs that -- through which the economics flow.

15 Q And would it be fair to say you were a  
16 significant minority investor at that point?

17 A Oh, we were absolutely a significant minority  
18 investor. CalPERS owned 99 percent of Fund II, which is  
19 the fund at issue here, and it owned 99.5 percent of  
20 Fund I.

21 Q Now with respect to your ability to obtain  
22 information from the fund to do your tax reporting and tax  
23 information that you need, what was your understanding of  
24 Centinela's rights to obtain information?

25 A Centinela's rights were essentially at the

1 discretion of the manager. The funds provide for  
2 reporting within 90 days of the close of the fiscal year,  
3 which is 12/31 for all of the underlying funds. But as a  
4 clause it says, "If the information is available." And  
5 that date was then changed after -- subsequent to our  
6 being terminated to 120 days.

7           So by the time 2016, 2017 rolls around -- I'm  
8 sorry -- 180 days. By the time 2016 and 2017 roll around,  
9 the manager has 180 days to make the initial report which  
10 is the financial statements. The tax statements, the K-1s  
11 lacked the audited financials.

12           Q So effectively, if you were to ask for any kind  
13 of report information, financial statement, anything,  
14 prior to April 15 of 2017, what would their response have  
15 been?

16           A I believe the technical term is the Heisman. We  
17 would have been stiffed. We would not have received the  
18 information.

19           Q Let's assume for the sake of discussion that they  
20 would have provided you what they had available on  
21 April 15th or April 1st. What would that documentation  
22 have been, and would it have allowed you to make any kind  
23 of conclusion about your tax obligations?

24           A It would most certainly not have been K-1s.  
25 If -- even if they had the financials delivered to them on

1 time, that would not have been sufficient time for them to  
2 create K-1s. And it is also historically the fact that  
3 they would only have had unaudited financial statements on  
4 April 1, 2016.

5 Those financial statements would not have shown  
6 this impending phantom income gain that resulted in the  
7 tax liability that's at issue here. In fact, when we were  
8 no -- we were not notified. The managers themselves, our  
9 replacement, did not notify us of this occurrence until  
10 late August, early September of 2017. In that report they  
11 expressed surprise.

12 Q And, Robert, can you explain to the panel what  
13 the income adjustment was that impacted your 2016  
14 reporting obligations?

15 A Yes, ma'am. There is something in the industry  
16 known as a waterfall. That's basically a formula that  
17 sets the agreement for profit sharing as between the  
18 investor and the manager of a fund like Capital Link I and  
19 Capital Link II. There is some traditional approaches to  
20 it. The traditional approaches generally include the  
21 first level of the waterfall; i.e., the first rights are  
22 that the investor gets all their capital back.

23 So 100 percent of the distributions go back to  
24 that investor before -- before you get to the next level  
25 of the waterfall. In our case, the next level of the

1 waterfall was a preferred return, which meant that  
2 CalPERS, in addition to getting all its capital back,  
3 would get an 8 percent return on that capital that was  
4 invested. So 100 percent of the capital in that core.  
5 The next level would go to CalPERS.

6 The third level of the waterfall having now a  
7 return capital -- 100 percent of CalPERS is invested  
8 capital -- and both invested capital and all capital, all  
9 capital deployed, including our fees. So they recovered  
10 100 percent of the money out of pocket and an 8 percent  
11 return on the money out of pocket. Level 3 is then a  
12 100 percent catch up by the manager.

13 Prior to 2016 we had -- excuse me -- period. The  
14 tax reporting follows that same formula. So there would  
15 be no tax -- would absorb the same tax attributes in a  
16 similar fashion. Although, there's a difference between  
17 book and tax reporting, so it's not one-to-one, but it  
18 could be the same tax waterfall. Prior to 2016, we had  
19 not reached anywhere near in our -- reports to us a point  
20 where we would be in Level 3. Again, this is why the  
21 manager expressed surprise when they reported to us.

22 Q And could you have determined, as you put, your  
23 Level 3 calculation from whatever unaudited financial  
24 might or might not have been available in April of 2017?

25 A No.

1           Q    And so, again to be clear, the documentation that  
2 might have been available in April would not have  
3 reflected the information Centinela would have needed to  
4 conclude its own tax obligations; is that correct?

5           A    Yes, ma'am.

6           MS. TURANCHIK:  At this point we have no  
7 additional questions.

8           JUDGE JOHNSON:  This is Judge Johnson.  Thank  
9 you, Appellant.

10           Let me turn to Respondent, Mr. Coutinho, do you  
11 have any questions for the Appellant?

12           MR. COUTINHO:  This is Brad Coutinho.  No  
13 questions for Appellant.

14           JUDGE JOHNSON:  Thank you.

15           Let me turn to the panel now.  Judge Akin, do you  
16 have any questions for the witness?

17           JUDGE AKIN:  Judge Akin here.  I think I have  
18 one, if you will bear with me for just a moment.  So okay.  
19 Looking at the exhibit that is attached to your  
20 declaration -- that's the excerpts from Section 9 of the  
21 fund agreement.  Specifically, that's Appellant's  
22 Exhibit 6.  I'm looking at the very last page.  It looks  
23 like the signature page on it is -- has as the fund  
24 manager an entity that -- I don't want to name for  
25 purposes of this public hearing.  But it looks like it's

1 not the fund manager that would have been in place in  
2 2016, 2017. I just wanted to check with Appellant to see  
3 that this was the most up-to-date fund agreement that was  
4 in place during the time period at issue.

5 MS. TURANCHIK: Robert, could you explain for  
6 Judge Akin what exactly happened between the fifth and the  
7 sixth amended agreements. Because that's sort of  
8 essentially what we need to get at here.

9 I think he's muted. That may be the problem.

10 MR. TAYLOR: Apologizes. Okay. So the -- again,  
11 we were terminated in October -- effective  
12 October 10th, 2012. The last document that we signed with  
13 CalPERS was October 11th, 2000 -- excuse me --  
14 October 10th -- October 2011. This document is --  
15 represents Credit Suisse's deal with CalPERS replacing us.  
16 Credit Suisse was acquired by Grosvenor Capital  
17 Management. So this is the predecessor energy -- entity.

18 You will note that the signature block actually  
19 has Centinela in it, and they have physically crossed it  
20 out. They're actually not allowed to sign on our behalf  
21 for the kind of agreement that was reflected in this  
22 document. That was one of the issues in our litigation  
23 with them. So I guess that was my assertion, but that's  
24 the connection. This is the agreement they signed and  
25 operated under.

1 JUDGE AKIN: Okay. So if I understand correctly,  
2 and this is the agreement that was in place, you know,  
3 around the time we're speaking about, so 2016, 2017?

4 MR. TAYLOR: Yes, ma'am.

5 JUDGE AKIN: Okay. Thank you. I don't have any  
6 further questions.

7 JUDGE JOHNSON: Thank you. This is Judge Johnson  
8 again.

9 Judge Tay, do you have any questions for the  
10 witness?

11 JUDGE TAY: Yeah, maybe just one question. I  
12 apologize, Mr. Taylor, but would you be able to explain to  
13 me a little bit more about this whole waterfall, for lack  
14 of a better word, how it was triggered during this year  
15 such that you would not have been able to anticipate the  
16 kind of recognition of income?

17 MR. TAYLOR: Yes, sir. So there's two elements  
18 to keep in mind. One is that there's the sort of cash  
19 waterfall and the tax waterfall. Both operate the same,  
20 but it's kind of like the difference between book and tax  
21 accounting. We actually have zero insight into the tax  
22 accounting. We do get the audit financial. We do get  
23 K-1s. But we get our share of the K-1s, not the fund  
24 shares of the K-1s.

25 Having said that, this is how the waterfall

1 works. Again, it's -- imagine -- the reason why they call  
2 it a waterfall is imagine taking a bucket of water and  
3 pouring it into a vessel with, kind of, three spouts. The  
4 first spout that gets filled up is the capital -- reflects  
5 the capital that the investor has already put in on both a  
6 cash basis and a tax basis.

7           So let's say CalPERS had invested \$100. The  
8 first \$100 that is a return from the fund goes to CalPERS.  
9 And also, this is a profit sharing mechanism. So let's  
10 say, for the sake of discussion, Centinela has a 5 percent  
11 profit. So it's not split 95/5. The first \$100 goes to  
12 CalPERS. Okay.

13           Now that CalPERS has got the first level filled,  
14 up the next level begins to fill up. They get an  
15 8 percent return -- preferred return. So let's say the  
16 money was only out for a year. The next \$8 million goes  
17 100 percent to CalPERS, not \$400,000 to Centinela and \$7.6  
18 thousand to CalPERS -- \$7.6 million to CalPERS. Does that  
19 make sense?

20           So they -- so they have now collected 108. But  
21 now they've gotten their 8 percent return, so we're at the  
22 third level. The first thing that happens at the third  
23 level is you back at the first two levels. And you asked  
24 the question that but for the waterfall, what would have  
25 been the split? 95/5, and you adjust everything at that



1 point, which is basically paying Centinela 100 percent of  
2 the profit that CalPERS has now made.

3 So the next \$400,000 comes to Centinela. That's  
4 what happened in 2016. Not on a cash basis because we  
5 would have seen that, but on a tax basis. So the tax  
6 books are doing the same thing that I just described, but  
7 we have no idea what's going on in the tax books. And --  
8 because back in 2016 we never got -- we didn't get cash  
9 for the tax attributes, right. But the tax in the tax  
10 bookkeeping those first two levels filled up, and that  
11 third one was hit.

12 And, again, as I explained, even the manager at  
13 this time, Grosvenor Capital Management -- I'm sorry.  
14 We're not supposed to mention that -- did not -- would --  
15 did not know that April 16th. Did not know sometime late  
16 that summer, the following -- that summer of 2017.

17 JUDGE TAY: Thank you. That's very helpful.  
18 Follow-up question to that, now I understand that you may  
19 not have seen that kind of cash flow. But did, I guess,  
20 as a member, did Centinela have access to, kind of,  
21 updated books and records of the fund?

22 MR. TAYLOR: No.

23 JUDGE TAY: Okay. Thank you.

24 Judge Johnson, no further questions.

25 JUDGE JOHNSON: Thank you, Judge Tay. This is

1 Judge Johnson.

2 I do have a question, Mr. Taylor. Thank you  
3 again for providing your testimony. I was looking at the  
4 agreement that was provided. That was the agreement in  
5 effect for 2016, the one that was attached to your  
6 statement. In looking at the Reporting to Member, Section  
7 9.4 there, do you see where it shows that you will have  
8 the, you know, not the audited, unaudited records 90 days  
9 after the end of each fiscal year -- each quarter of each  
10 fiscal year. So were they providing you those records  
11 during the year or different -- just get anything during  
12 the year, I guess I should ask?

13 MR. TAYLOR: Yes, we did. We got unaudited  
14 financials.

15 JUDGE JOHNSON: Okay. And the large, I guess,  
16 you know, 20 times, kind of, different income that came  
17 attributed to you during this time, do you know if there  
18 was any very large asset that was sold during the year  
19 that kind of contributed to kicking in to the third level?

20 MR. TAYLOR: No. There was not a single asset  
21 that kicked it in to the third level.

22 JUDGE JOHNSON: Okay. And do you remember, do  
23 you recall looking at those quarterly statements you got  
24 during the year that there's any indication that the  
25 amount was going to be much larger than it was in previous

1 years?

2 MR. TAYLOR: I do remember looking at them.  
3 There was no indication.

4 JUDGE JOHNSON: Okay. Thank you, Mr. Taylor.

5 Let me ask just really quick again if there are  
6 any more questions from Judge Akin?

7 JUDGE AKIN: Sorry. Trying to unmute. No  
8 further questions from me. Judge Akin speaking. Thank  
9 you.

10 JUDGE JOHNSON: Thank you. And Judge Tay, any  
11 further questions?

12 JUDGE TAY: No further questions at this time.  
13 Thank you.

14 JUDGE JOHNSON: Thank you.

15 And I'll turn it back to Ms. Turanchik. Again,  
16 if you have any redirect questions you'd like to ask  
17 Mr. Taylor at this time, you can.

18 MS. TURANCHIK: Let me just follow up -- because  
19 this is a line of questioning that you all obviously  
20 focused on because it's a critical element of this case,  
21 and that is the element of knowledge prior to April 15th.

22

23 BY MS. TURANCHIK:

24 Q Robert, if you could please, again, discuss for  
25 the panel the fact that the audited -- excuse me -- the

1 unaudited financials, which you may have had access prior  
2 to April 15, would not have reflected the information  
3 necessary for you to make any determination on Centinela's  
4 tax obligation, because this was effectively a tax  
5 adjustment that was made by the accountants; is that  
6 correct?

7 A That is correct. The unaudited financials are  
8 just that. The are financials and not tax returns.  
9 There's no tax information in the financials.

10 Q And there was no asset sold, no -- nothing that  
11 would have indicated in those unaudited financials that  
12 there may have been an influx of cash or income such as  
13 that this waterfall may have continued down the levels?

14 A There was no single asset sold. And, in fact, we  
15 got very cursory reports on the actual underlying  
16 activities. When I say financials, these are not what one  
17 might typically think of as a public traded company.  
18 Financials are not detailed -- with details MDA,  
19 management discussion and analysis. It's a very summary  
20 report, particularly, the quarterly financials. It's  
21 in --

22 Q And -- sorry.

23 A It's an income statement. It's just a balance  
24 sheet. You know, it's a cash flow statement and P-cap, a  
25 partner's capital something. I don't recall what P -- I

1 don't recall what P-cap stands for, but it tells you what  
2 your capital position is. And none of those documents  
3 indicated anything different from the prior years in terms  
4 of what our exceptions ought to be.

5 Q And do you recall what the average income was for  
6 the prior years between your exit as fund manager in 2012  
7 and 2015 year?

8 A It was in the range between sort of 4  
9 and \$600,000.

10 MS. TURANCHIK: Okay. I don't think I have any  
11 further questions to follow up on those issues. Thank  
12 you, Your Honor.

13 JUDGE JOHNSON: This is Judge Johnson again.  
14 Thank you very much.

15 And with that, we're ready to go into the  
16 Appellant's legal arguments. We will start with  
17 Ms. Turanchik. You will have 10 minutes. Are you ready  
18 to go for it this time?

19 MS. TURANCHIK: I am. Thank you, Judge Johnson.

20 JUDGE JOHNSON: Please begin.

21

22 PRESENTATION

23 MS. TURANCHIK: This is Lydia Turanchik again.

24 As stated in our opening, FTB's entire argument  
25 here is premised on a knew or should have known standard

1 with respect to the additional allocation of income for  
2 2016. The FTB's arguments are flawed. What they've  
3 utterly failed to accept is that by April 15, 2017,  
4 Mr. Taylor did not know and could not have known under any  
5 circumstances that a significant income event would occur  
6 with respect to the 2016 year.

7 The event here was an accounting adjustment made  
8 by the accountants in mid-2017 to reflect the tax  
9 accounting issue. It was not a traditional income event.  
10 It was not a sale of property or a business in 2016.  
11 There was no significant asset movement on the books in  
12 2016. There was nothing that would have been reflected in  
13 the documentation prior to April 15, 2017, that this  
14 significant increase in income was coming.

15 Put simply, any investigation of an income  
16 adjustment prior to April 15, 2017, would have been futile  
17 because Mr. Taylor was not entitled to any tax information  
18 prior to April 15, 2017. And the information that would  
19 have been available prior to that date would not have  
20 reflected this income adjustment. We agree with the  
21 Franchise Tax Board that a taxpayer cannot stick their  
22 head in the sand and ignore potential income events and  
23 corresponding tax obligations if there's knowledge of such  
24 an event.

25 But these are not our facts. In the three

1 primary cases cited by the Franchise Tax Board in Scott,  
2 Sleight, and Campbell, all taxpayers had access to  
3 information and knowledge of an actual event triggering  
4 gain. In Scott it was a sale of rental units and the  
5 liquidation of a rental property. In Sleight it was the  
6 sale of real property and an apparent failed exchange.  
7 And in Campbell it was partnership income that related to  
8 an adjustment over which the taxpayer controlled all  
9 necessary information.

10 And all cases there was actual knowledge and  
11 access to records. We have neither here. The same holds  
12 true on the facts of this case are compared to Moren. In  
13 Moren the specific tax treatment of distribution to  
14 beneficiary was unknown at the time its tax payment was  
15 due. In this case in Moren. However, Mr. Moren was  
16 notified of a likely tax obligation, via letter, received  
17 on April 14 prior to the tax payment deadline.

18 He made no payment in response to that letter.  
19 He did not directly follow up with a response to that  
20 letter. He failed to make any follow-up request for  
21 information between April and August when his Schedule  
22 K-1s were received. And he didn't make a payment until  
23 October 15, 2016. It's very similar to what we have here.

24 Mr. Moren had reasonable cause because all of the  
25 amount tax due was, in fact, indeterminant. Mr. Moren did

1 not have access to the necessary information, and this was  
2 true whether Mr. Moren followed up or not.

3 Here the facts are even more favorable.  
4 Mr. Taylor did not know and could not have known that  
5 there was going to be an accounting change with respect to  
6 the 2015 and 2016 year in April 2017 or for months  
7 afterwards. This lack of knowledge immediately  
8 differentiates this case from others cited by the FTB  
9 where there is clear knowledge of an income event at the  
10 time the tax payment was due. At the time the tax payment  
11 was due here, the accounting adjustments had not yet been  
12 made. And the unaudited financials did not reflect that  
13 such an accounting adjustment was going to be made.

14 As a result, there was an actual impossibility  
15 for Mr. Taylor to obtain any information regarding the tax  
16 event as of April 15th, 2017, and for months afterward.  
17 Moreover, as Mr. Moren, Mr. Taylor did not have access to  
18 the information in any event. The necessary documentation  
19 remained in the hands of fund representative, not just  
20 non-responsive as in Moren, but downright hostile beyond  
21 fundamental litigation.

22 Put simply, taxpayers are not required to take  
23 every hypothetically available step to determine a tax  
24 liability where there is neither knowledge of an income  
25 event nor access to the necessary records. This much is



1 clear from the case law and emphasized in Moren. To  
2 impose the standard required by the FTB would be to impose  
3 a strict liability standard on a penalty where Congress  
4 and the California legislature clearly intended there be a  
5 reasonable cause exception.

6 There's no question with the lack of knowledge  
7 with respect to the income allocation, coupled with the  
8 lack of access to the necessary information results in  
9 circumstances beyond the taxpayer's control and a finding  
10 of reasonable cause. It is for these same reasons that  
11 the estimated tax penalty must be abated.

12 As stated in our opening, the estimated tax  
13 penalty may be waived where there is a limited unusual  
14 circumstance and the imposition of penalty would be  
15 against equity and good conscious. The Internal Revenue  
16 Manual provides a list of what does not constitute an  
17 unusual circumstance. And one of the identified items is  
18 if the circumstance that prevented compliance was  
19 reasonably foreseeable.

20 Stated differently, however, there are unusual  
21 circumstances if the circumstance that prevent compliance  
22 was not reasonably foreseeable. For all of the factual  
23 reasons that reasonable cause exists, it is equally true  
24 that the events here were not reasonably foreseeable. The  
25 taxpayer had no reason to believe there would be

1 additional tax liability at the time the time estimated  
2 tax payments were due. The estimated tax penalty must  
3 also be waived in this matter.

4 Thank you.

5 JUDGE JOHNSON: This is Judge Johnson. Thank  
6 you.

7 Now, we will turn to Respondent to provide their  
8 10 minutes of arguments. You may begin when you're ready.

9 MR. COUTINHO: Good afternoon. This is Brad  
10 Coutinho. Before I get started, I've had some audio  
11 issues in the past with Webex. If there are any issues,  
12 if any of the judges or Appellants have trouble hearing  
13 me, I'd be happy to call in. Feel free to cut me off at  
14 any time.

15 JUDGE JOHNSON: Thank you.

16

17 PRESENTATION

18 MR. COUTINHO: This appeal is about Appellant's  
19 attempts to redefine reasonable cause beyond the perimeter  
20 set by statute and case law. The late payment and  
21 estimate tax penalties imposed for the 2016 tax year  
22 should not be abated for two specific reasons.

23 The first is Appellant's decision to wait until  
24 September 2017 to determine their tax liability does not  
25 meet the reasonable cause standard. Second, Appellant's

1 justification for failing to meet the timely tax payments  
2 does not meet the statutory requirements for waiver of the  
3 estimated tax payment.

4 In Appellant arguments today, they have made a  
5 lot of arguments regarding the knowledge factor. While  
6 knowledge is a consideration in determining whether or not  
7 reasonable cause has been met, it is not the only thing to  
8 consider. A recent precedential opinion your office held,  
9 cited to the case Frias versus Commissioner, a U.S. Tax  
10 Court decision.

11 In Frias, the U.S. Tax Court found that the most  
12 important factor in determining reasonable cause in good  
13 faith --

14 JUDGE JOHNSON: Mr. Coutinho, sorry. This is  
15 Judge Johnson. I'm sorry to interrupt you there. I think  
16 we are having you cut in and out a little bit with the  
17 audio if you want to switch over to the call-in option.

18 MR. COUTINHO: Yeah. Just give me one second.

19 JUDGE JOHNSON: Absolutely.

20 (There was a pause in the proceedings.)

21 MR. COUTINHO: Going back to my first point,  
22 Appellants have made arguments today regarding the  
23 knowledge consideration for reasonable cause. However,  
24 that's not the only consideration. In a recent U.S. Tax  
25 Court decision, Frias versus Commissioner, the U.S. Tax

1 Court found that the most important factor in determining  
2 reasonable cause and good faith, is the extent of the  
3 taxpayer's efforts to determine his or her tax liability.

4 Similarly in the appeal of Harry Moren, your  
5 office weighed heavily the taxpayer and their efforts to  
6 acquire the information necessary to determine the tax  
7 liability associated with the distribution from the  
8 estate. In Moren your office directly stated, "An  
9 assertion that the records were difficult to obtain  
10 without any substantiation of effort, is insufficient to  
11 show reasonable cause."

12 Moren and Frias diverged from the facts of this  
13 appeal in that Appellant has not shown that they've made  
14 any effort prior to April 15th to figure out their correct  
15 tax liability. As Appellant stated, the income that  
16 caused the late payment and estimate tax penalties were  
17 due to Schedule K-1s that were received late. The  
18 Schedule K-1s that Appellants received were received for  
19 the four prior tax years, and each one was over \$350,000.

20 Appellants have stated today that they did not  
21 know that the Schedule K-1 would be as much as it was.  
22 But what they did know was that they would be receiving a  
23 K-1. They knew that the distribution would be  
24 significant, and they knew, most importantly, that it  
25 would be taxable, unlike the taxpayers in both Moren and

1 Frias.

2           Despite being armed with this knowledge, there is  
3 nothing in the record to reflect that there were any  
4 e-mails or phone-call logs or other evidence to show that  
5 Appellants tried to correctly figure out their correct tax  
6 liability prior to April 15th. Appellants' decision to  
7 wait for their Schedule K-1 until September 27th to  
8 determine their tax liability does not meet the standard  
9 for reasonable cause.

10           In addition, in the appeal of Moren, your office  
11 found that filing history may be evidence of good faith  
12 and to show good faith and not negligence on the facts of  
13 the taxpayer. However, in this case, Appellants have  
14 incurred late payment and estimate tax penalties for the  
15 2014 and 2015, the two preceding tax years. Accordingly,  
16 this is not one of those cases where the filing history  
17 tips in favor of finding reasonable cause.

18           To my second point, Appellant has not -- the  
19 facts of this appeal do not establish that there should be  
20 a waiver for the estimate tax penalty. As cited to in  
21 FTB's opening brief, the Internal Revenue Manual states  
22 explicitly, "Income derived from pass-through entities is  
23 not excludable from the estimate tax requirements merely  
24 because such income is not known until the Schedule K-1 is  
25 received after the close of the taxable year."

1           Similarly, in the appeal of Gerald Johnson, a  
2           precedential opinion from your office, it found that the  
3           estimate tax penalty could not be abated even though there  
4           was a gain from the sale of real property, because it was  
5           not the unusual circumstance that would warrant abatement  
6           of the penalty.

7           In the appeal of Johnson, your office looked at  
8           the words that preceded an unusual circumstance,  
9           specifically the words casualty and disaster, in holding  
10          the typically and unusual circumstance, thus warrant an  
11          unexpected event that causes a hardship or loss. Similar  
12          to Johnson, the gain from partnership income is not the  
13          type of unusual circumstance that warrants abatement --  
14          warrants waiver of the estimate tax penalty.

15          Accordingly, for those reasons, the late payment  
16          penalty and the estimate tax penalty should not be abated,  
17          and Respondent's position should be sustained.

18          Thank you.

19          JUDGE JOHNSON: Thank you, Mr. Coutinho. This is  
20          Judge Johnson again. I'll provide five minutes for  
21          Ms. Turanchik to provide a rebuttal if you would like. I  
22          believe you might be muted.

23          MS. TURANCHIK: I'm. I'm sorry. I didn't turn  
24          it off.

25          JUDGE JOHNSON: I'll provide five minutes for

1 Ms. Turanchik to provide a rebuttal, if she'd like.

2 I believe you might be mute. Ms. Turanchik, do  
3 you have your microphone on?

4 MS. TURANCHIK: Better?

5 JUDGE JOHNSON: That's better. Thank you.

6 MS. TURANCHIK: I'm sorry. I didn't turn it off,  
7 so I'm not sure what happened there.

8

9

REBUTTAL STATEMENT

10 MS. TURANCHIK: I sit here with a little level of  
11 frustration at the Franchise Tax Board's response because  
12 I feel like they are trying to lump us into every other  
13 individual who has complained about a late K-1 and said  
14 there's reasonable because I didn't know exactly what my  
15 tax liability was going to be. We're not talking about a  
16 situation here where there was a difference between \$100  
17 and \$500.

18 The Franchise Tax Board refers to this notion of  
19 decision to wait for the K-1. There was no decision to  
20 wait for a K-1 here. They had no idea that this potential  
21 income was looming. And the Franchise Tax Board then  
22 points to this issue that, well, you've had some prior  
23 year's of underpaid tax, which is true. But that also  
24 goes to Mr. Taylor's point that post 2012, he did not have  
25 access to the information he needed to properly prepare

1 his tax returns, number one.

2 And number two, in the prior years -- let's be  
3 honest -- the penalties were under \$1,000. There is not  
4 an individual in the world who is going to invest the time  
5 and resources that it takes to fight these penalties, as  
6 evidenced by this today, to fight a \$400 and a \$600  
7 penalty.

8 So I think what's being ignored by the Franchise  
9 Tax Board is the fact that we're not saying that we simply  
10 waited for the K-1s and, you know, we were being lazy and  
11 didn't do anything. There was nothing that could have  
12 been done here. The FTB acts like this knowledge  
13 requirement is not a requirement, that it's not real. And  
14 the reality is there is not a case out there that applies  
15 an underpayment tax penalty in a situation where the  
16 taxpayer had literally no idea that there was going to be  
17 an additional tax imposed.

18 And so I find the argument very frustrating on  
19 that front because, yes, they did have some prior  
20 underpayment penalties, but that was in large part because  
21 they couldn't get access to the information that they  
22 needed in a timely fashion. And that simply supports our  
23 argument moving forward that when it really mattered and  
24 we had these massive income adjustments, that they still  
25 weren't getting the information that they needed. It just



1 becomes kind of this empirical problem that there was  
2 nothing they could do anything about.

3 We do believe that the FTB position is  
4 effectively transitioning this into a strict liability  
5 penalty. Because what they're saying is, if you ever have  
6 a situation where you have an underpayment and you haven't  
7 made some effort to determine what it is, even though you  
8 have no reason to go look for that tax event, that you're  
9 somehow responsible. And I actually believe -- and maybe  
10 I'm completely misreading Moren, but the benefit is we  
11 have the author of that decision on this panel -- is that  
12 this taxpayer in Moren didn't take particular efforts to  
13 determine what the tax liability was.

14 As I indicated previously, he didn't follow up.  
15 His co-beneficiary sent one e-mail saying, "I think you  
16 might be wrong on this." And there was no further  
17 communication on this until they actually received the  
18 K-1s in August. There was no follow up. And the rationale  
19 was, well, they were unresponsive previously, and as a  
20 result of that, we really didn't bother to follow up. And  
21 that seemed to be okay with this panel.

22 And that is almost entirely different from what  
23 we have here, which is actually a hostile situation where  
24 they were not going to be able to obtain the information  
25 they needed, part because of this hostile relationship.

1 But also in part because it simply wasn't available before  
2 April 15th. There was simply no indication that this  
3 income event was coming in 2016. And I guess that's where  
4 I feel like the FTB is sort of missing our argument that  
5 we 100 percent agree with them on this notion that if  
6 you've got an idea income is coming and you know precisely  
7 what's going to be on that K-1, that's not an excuse. But  
8 that's also not our facts here.

9 JUDGE JOHNSON: This is Judge Johnson. Thank  
10 you.

11 I will now turn to questions from the panel.  
12 I'll start again with Judge Akin. Do you have any  
13 questions for the parties?

14 JUDGE AKIN: Just one quick follow-up question  
15 maybe for Appellants. Going back to the whole, you know,  
16 cascading waterfall idea, is there somewhere in the fund  
17 agreement you can point the panel to that we can reference  
18 that?

19 MS. TURANCHIK: Robert, I'm going to let you  
20 field that.

21 MR. TAYLOR: Yeah. Let me -- I'll find it.

22 JUDGE AKIN: Yeah. Judge Akin speaking. If you  
23 could just generally point us to the sections.

24 MR. TAYLOR: Section 4 is the waterfall section.

25 JUDGE AKIN: Okay.

1           MR. TAYLOR: So you will see that -- I should say  
2 the -- off the distribution. 4.2 talks to distributions.  
3 And then there's something that tax to tax distributions  
4 that basically -- oh, I'm sorry. That's the wrong one.  
5 It doesn't explicitly spell that. You know what, it's  
6 funny that way.

7           MS. TURANCHIK: Judge Akin, would you like us to  
8 get back to the panel with a response on this? I don't  
9 want to waste your time looking for this.

10          JUDGE AKIN: I think if it's covered by Section 4  
11 and the distribution language in the agreement, I think we  
12 can find it. I just wanted, you know, a place to start  
13 looking for it.

14          MR. TAYLOR: On Section 4 -- sorry.

15          JUDGE AKIN: Go ahead.

16          MR. TAYLOR: Section 4.2 is a distribution  
17 provision. That's what you need to understand the basic  
18 waterfall. There is a link here somewhere that speaks  
19 specifically to the tax waterfall that basically says it  
20 follows that on a tax basis. But it turns out it's in a  
21 different section, and I don't remember offhand where it  
22 is.

23          JUDGE AKIN: Okay. I think -- Judge Akins  
24 speaking again. I think that answers my question. It  
25 gives me a general place to start. So thank you very

1 much. No additional questions for me at the time.

2 JUDGE JOHNSON: Thank you. This is Judge Johnson  
3 again.

4 Let me turn to Judge Tay. Do you have any  
5 questions for the parties?

6 JUDGE TAY: Yes. This is Judge Tay. Appellant,  
7 thank you for pointing to that section of the agreement  
8 that contains the distribution and the tax agreement of  
9 the waterfall. My understanding is that you've submitted  
10 two different copies of the member agreement. Now, would  
11 that be also included in the agreement that you provide in  
12 Exhibit 1 to the declaration? I don't think we have a  
13 full agreement of that amended agreement.

14 MS. TURANCHIK: You do not. What happened  
15 between the filing of the 5th and 6th amended -- the 5th  
16 amended, which you have a complete copy of, is the last  
17 agreement that was entered into agreed to by Centinela.  
18 The 6th amended is the version that we have that is sort  
19 of technically in effect and a difference in the tax  
20 language, which is why we attached that to his declaration  
21 because it was evidence of the transition of the formally  
22 90 days to respond under the agreement that Centinela had  
23 actually agreed to for tax information, versus the  
24 180 days that was now imposed by the new agreement when  
25 Centinela had gotten kicked out.

1           Centinela still takes the position that 6th  
2 agreement shouldn't really be valid. But we did not  
3 produce a complete copy because for most of the sections,  
4 it's not different. But if it is different in that  
5 distribution provision, then, Robert, can we get them that  
6 particular section if it's different?

7           MR. TAYLOR: It is not different.

8           MS. TURANCHIK: That's what we thought. But  
9 other than that tax, the notification on tax issues, there  
10 are not significant changes for our purposes between 5 and  
11 6. And, again, 5 is the full version you have that was  
12 actually signed by Robert on behalf of Centinela. 6 is  
13 the one that CalPERS and the fund manager take or assert  
14 that it should have been in control during 2015 and 2016.

15           JUDGE TAY: Thank you. Another question for  
16 Appellant. I note that in section -- I think it's 9.5 of  
17 the agreement, the manager has the right to quarterly  
18 meetings with the fund to discuss various efforts and  
19 strategies and things like that. Did you participate in  
20 any of those in the relevant tax year?

21           MR. TAYLOR: No. We were not the managers.

22           JUDGE TAY: I can't hear you.

23           MR. TAYLOR: I'm sorry. Am I on mute? I'm not  
24 on mute. No, we did not participate. We were not invited  
25 to participate. We're not the manager.

1 JUDGE TAY: Okay. Thank you.

2 MR. TAYLOR: I'm sorry. If I can go back?

3 Section 3.3 is the capital accounting that drives the tax  
4 accounting.

5 JUDGE TAY: Thank you. And you said 3.3?

6 MR. TAYLOR: Yes.

7 JUDGE TAY: Okay. Thank you. Appellant, did you  
8 provide copies of the quarterly reports for the record?

9 MS. TURANCHIK: I'm sorry. Judge Tay, I missed  
10 that. What did you say?

11 JUDGE TAY: Oh, I apologize. I was wondering if  
12 Appellant had provided copies of the quarterly reports  
13 that they received that Mr. Taylor references.

14 MS. TURANCHIK: We did not submit those into the  
15 record. No.

16 JUDGE TAY: Okay. Question for Franchise Tax  
17 Board. You mentioned the taxpayer's responsibility to  
18 make reasonable efforts. In your opinion would reviewing  
19 such quarterly reports rise to the level of those efforts?

20 MR. COUTINHO: This is Brad Coutinho. I think  
21 reviewing the quarterly reports would help. However, I  
22 think exhausting every effort possible, contacting the  
23 fund, contacting the CPA prior to April 15th, some modicum  
24 of effort is similar to what was found in Moren. As soon  
25 as they realized that there was a tax obligation, there

1 was efforts taken.

2 And so in this case it appears the Appellants had  
3 knowledge that there would be consequences. And the  
4 record doesn't reflect any efforts that Appellants took to  
5 determine that prior to April 15th. Whether they got it  
6 right or wrong, it doesn't appear that they took any  
7 efforts prior to then to determine what the schedule K-1  
8 amount would have been.

9 JUDGE TAY: Okay. Thank you.

10 Sorry. One more question for Appellant. You  
11 mentioned your efforts in prior years to determine what  
12 the proper tax liability would be that would result from  
13 income from the funds. And if I understand you right, it  
14 seems like it was the penalty for a late payment was  
15 minimal. And so it was not of that much concern. Would  
16 that be true of the approach to determine tax liability  
17 for this year as well?

18 MR. TAYLOR: No. That's not -- no it would not  
19 be, and I would not characterize the approach to prior  
20 years that way either. The penalty would be minimal.  
21 What I would say is the methodology that we used got us  
22 pretty close. And as a result -- in fact to be clear, I'm  
23 not saying we're wrong. My counsel got it right. It  
24 wasn't worth fighting over.

25 So we had a methodology. I had a methodology

1 that got me, you know, with good faith to a number that I  
2 believe would be my liability. And the results show that  
3 it was pretty close, and I continued to apply the same  
4 methodology. And, again, I did rely on the quarterly  
5 reports. But earlier when I said they were not the same  
6 as -- excuse me -- I should say unaudited reports.

7 They're not the same as what you might expect in  
8 a publicly-traded company's report, which is not to say  
9 that we dismiss them. We looked at them. I looked at  
10 them. And, again, when you look at reports, the reports  
11 year to year look very much like the prior years. Again,  
12 the history shows the prior years got us to a number that  
13 was essentially our liability.

14 And this -- but it does not contain the tax  
15 information, the sort of post-financial reporting  
16 adjustment that took place that resulted in a big surprise  
17 for tax year 2016.

18 JUDGE TAY: Thank you. This is Judge Tay. No  
19 further questions.

20 JUDGE JOHNSON: Thank you Judge Tay. This is  
21 Judge Johnson.

22 I have a question for Appellants. Going back to  
23 the portion of the Section 9 document that's provided with  
24 the declaration, just to clarify. So that was the 6th  
25 amended agreement that was in effect for the year at



1 issue, 2016; is that correct?

2 MS. TURANCHIK: This is Lydia Turanchik. Yes,  
3 that's correct, Your Honor.

4 JUDGE JOHNSON: Okay. I just want to clarify.  
5 Another signature page actually says "5th Amendment" and  
6 restate it. But I know it's a different document than the  
7 full 5th amendment that you provided. So I just want to  
8 clarify that it just seems to be just a mistake that  
9 wasn't updated on the form. Is that right?

10 MS. TURANCHIK: Robert, is that correct? I don't  
11 want to answer that factual question.

12 MR. TAYLOR: Yes. The -- you're talking about in  
13 the parenthetical at the bottom?

14 JUDGE JOHNSON: Right.

15 MR. TAYLOR: Yeah. They just made a mistake. I  
16 mean, again, we weren't -- we weren't involved in the  
17 execution of this document. This document was given to us  
18 as the document in effect when we got into litigation as a  
19 result of discovery.

20 JUDGE JOHNSON: Okay. Thank you. And I think we  
21 might refer to the document in our opinion. I don't think  
22 it's necessarily going to be, you know, the smoking gun or  
23 anything like that, but I just want to make sure everyone  
24 is comfortable with it.

25 Franchise Tax Board, do you have any concerns

1 over that exhibit as being the terms that were in effect  
2 for the year at issue?

3 MR. COUTINHO: No. This is Brad Coutinho. No  
4 issues with that document.

5 JUDGE JOHNSON: Okay. Thank you. Just want to  
6 double check.

7 And let me turn back to Appellants, if I can.  
8 Perhaps, Mr. Taylor, you can answer this. A question  
9 about whether you have any reason to believe there's tax  
10 liability waiting, noting the prior year's K-1s came late,  
11 and they had some amounts on them that ended up resulting  
12 in estimated tax penalties. So you said you had a formula  
13 that you kind of used to try to estimate the amount that  
14 would be due; is that correct?

15 MR. TAYLOR: I think a formula would be too kind  
16 a term. I mean, essentially, you know, again looking at  
17 the -- we do have cash flows. We do get those reports.  
18 The cash flows appear to be, you know, and then if that --  
19 if you want to call that the formula, in proportion to  
20 those cash flows, they're higher or lower. I adjusted  
21 what I expected to get in the K-1s.

22 JUDGE JOHNSON: Okay. And you said in 2014 and  
23 2015 and presumably prior years you were operating under a  
24 similar plan; you were getting pretty close?

25 MR. TAYLOR: Yes. In fact, I guess the FTB does

1 not have the records, but the reverse was true, I believe,  
2 for '12 and '13, i.e., we overpaid.

3 JUDGE JOHNSON: Okay. And you used that same  
4 formula and made payments by April 15th, 2017 for the 2016  
5 tax year?

6 MR. TAYLOR: Yes, sir.

7 JUDGE JOHNSON: Okay. So the amount that was  
8 paid with the October return filing was only the  
9 additional amount that was claimed unforeseeable?

10 MR. TAYLOR: Yes, sir.

11 JUDGE JOHNSON: Okay. Thank you. And just to  
12 fully clarify the record and to get it straight, were  
13 there any efforts at all made after the closing of 2016?  
14 Any e-mails, calls, letters, anything to the manager to  
15 get financial tax documents?

16 MR. TAYLOR: Yes. I mean, they called us. So  
17 there were a set of calls and e-mails that were exchanged,  
18 because they called us before they actually finished the  
19 work. As I mentioned, it was a surprise to them, and they  
20 wanted to get the information as soon as they had it to  
21 us. Again, remember we're in a state of hostility. They  
22 don't want to create any issues between us that they might  
23 be exposed on. So they were both extraordinarily afraid  
24 of us but also highly motivated to please CalPERS and not  
25 to do any favors for us.

1           JUDGE JOHNSON: Okay. And that was a phone call  
2 you said, or was that letters or e-mails?

3           MR. TAYLOR: There was a -- I think the first  
4 interaction was a phone call that said this is coming. It  
5 was before the Labor Day, not, you know, kind of order --  
6 discussion. So not numbers you can hang your hat on. And  
7 then after the Labor Day I think they -- I don't recall  
8 whether it was a subsequent call, but there was something  
9 more definite.

10           It must have been an e-mail because it was still  
11 not quite the K-1s. I think the K-1s didn't show up for  
12 another few weeks. It took them another few weeks to  
13 actually figure out the actual number.

14           MS. TURANCHIK: Judge Johnson, this is Lydia  
15 Turanchik. If I could just interject. This chronology is  
16 actually included in our Exhibit 2. The CPA has actually  
17 identified when there had been communication and efforts  
18 to determine these issues.

19           JUDGE JOHNSON: Okay. So the statement from the  
20 CPA is sort of the answers I'm looking for, I guess, as  
21 far as what interactions occurred and whether there's  
22 written proof of those interactions. Okay. Thank you.  
23 And with that I have no further questions.

24           Let me do a visual checks of my panel members to  
25 see if they have any further question. Calling them out,

1 I don't see any positive shaking. So I think we're good.

2 We can go to our closing arguments, which will be  
3 the end of the appeal here.

4 We'll start with Franchise Tax Board. Would you  
5 like to do a two-minute closing argument?

6 MR. COUTINHO: Yes, I would.

7

8 CLOSING STATEMENT

9 MR. COUTINHO: This is Brad Coutinho.

10 Appellants have made arguments today that the  
11 late payment penalty and estimate tax penalty are in  
12 effect strict liability penalties. However, that's  
13 overlooking cases that have found reasonable cause, such  
14 as the appeal of Harry Moren, and the U.S. Tax Court that  
15 I cited to earlier, Frias versus Commissioner.

16 Both of those cases found reasonable cause even  
17 though the taxpayers in those cases were unable to have  
18 the documents by the April 15th, deadline. And in both of  
19 those cases, they were able to find that reasonable cause  
20 did exist. It's because of the efforts taken by the  
21 taxpayers to try and determine their tax liability prior  
22 to when their taxes were due, prior to April 15th.

23 In this case, we have a lot of statements from  
24 Appellants and lot of assertions of what they think the  
25 fund would have said; what they think the fund would have

1 given them; and what would have happened. However, the  
2 mere assertions from Appellant is not sufficient to  
3 trigger reasonable cause. As stated directly in Moren,  
4 the assertion that the records were difficult to obtain  
5 without any substantiation of the efforts taken, is  
6 insufficient to show reasonable cause.

7 In this case, Appellant has not provided any  
8 e-mails or phone logs. The e-mails that they referenced  
9 took place as they stated in September -- appears to be  
10 September 2017, and that's when the story begins, that  
11 Appellants told the story. There's nothing in the record  
12 to show prior what happened prior to that August,  
13 September deadline.

14 In addition, while Appellants have provided  
15 records that show that they should have received the  
16 financial records in/or around June 30th, it doesn't show  
17 that there was any efforts after that time to correctly  
18 determine their tax liability. And as stated in the  
19 appeal of Moren, taxpayer must show reasonable cause  
20 through the entire length of time, and that has not been  
21 met in this case. And, therefore, for those reasons,  
22 neither the late payment nor the estimate tax penalty  
23 should be abated.

24 Thank you.

25 JUDGE JOHNSON: Thank you, Respondent.

1           And we'll turn to Appellant for a two-minute  
2 closing as well.

3           MS. TURANCHIK: Thank you, Judge Johnson.

4

5

CLOSING STATEMENT

6           MS. TURANCHIK: This is Lydia Turanchik. And  
7 thank you, panel.

8           The FTB's position here is effectively that  
9 because Mr. Taylor did not seek documents he was not  
10 entitled to and did not even exist as of April 15, 2017,  
11 that this should somehow automatically result in the  
12 imposition of a failure to pay penalty. It doesn't matter  
13 to them that there is no knowledge underlying any  
14 additional tax obligation here. But the facts do matter  
15 in a reasonable cause analysis.

16           Even if efforts were taken here to identify an  
17 additional income allocation, no additional payment amount  
18 could have been determined. Not only were the records  
19 maintained by the openly hostile fund, not -- they never  
20 would have released them early. The records maintain up  
21 to April 15, 2017, would not have reflected the income  
22 increase.

23           You heard Mr. Taylor testify to this fact. He  
24 reviewed the quarterlies. He reviewed the information he  
25 had. The asset profit and loss balance sheets, none of

1 that was going to indicate this tax adjustment that was  
2 made by the accountants in 2017.

3 And to say that Mr. Taylor is responsible for  
4 penalties here, ignores the poor premise behind the  
5 imposition of penalties in the first place. False. The  
6 FTB is essentially arguing that Mr. Taylor should have  
7 assumed there was going to be an increase in income in  
8 2016 with no factual basis for this assumption. He  
9 testified he used the formula. He used the standard that  
10 he applied year in and year out. He had no knowledge that  
11 this income allocation was coming.

12 But the FTB's argument is very similar to the  
13 argument the FTB made in Moren. While I appreciate now  
14 that they are singing the praises of the determination,  
15 the fact is the Franchise Tax Board's position in that  
16 case was that the taxpayer should have made a tax payment  
17 sufficient to cover the liability as if 100 percent of the  
18 distribution was taxable.

19 And the OTA said no. While the suggested action  
20 would have been the most cautious approach, it does not  
21 mean it's the only reasonable and prudent option. Here,  
22 the FTB essentially wanted Mr. Taylor to guess at a  
23 potential tax liability without even the benefit of a  
24 total possible tax amount as in Moren. They knew what the  
25 distribution was. The only question was how much of it



1 was taxable.

2 We don't have even that level of fact in this  
3 case prior to April 15, 2017. The FTB's position simply  
4 ignores reality and imposes what I will still call as a  
5 strict liability penalty based on the position they're  
6 taking in cases and circumstances where the taxpayer did  
7 not know and had zero reason to know an additional tax  
8 liability, a liability resulting from actions taken, not  
9 only out of the control of the taxpayer, but also after  
10 the close of the year in question. This is simply not the  
11 proper standard, and the FTB's position on this matter  
12 should not be sustained.

13 I also want to point out this heavy reliance on  
14 Moren, and this notion that the taxpayer did so much to  
15 investigate their obligation. I'm going to restate what I  
16 said earlier. Mr. Moren was notified of a likely tax  
17 obligation via letter prior to the due date for the  
18 payments. He made no tax payment in response to that  
19 payment. He did not directly follow up the accountants  
20 himself in response to that letter.

21 As I read the record, the only follow up that  
22 occurred was the co-beneficiary sent a responsive e-mail.  
23 There was no follow-up request for information in that  
24 case between April and August. And nothing happened until  
25 the issuance of Schedule K-1s in August and September, and

1 the payment in October of 2016.

2 I believe these facts in our case are better, and  
3 I believe that Mr. Taylor deserves to be found to have  
4 reasonable cause with respect to the failure to pay  
5 penalty. And if he does suffer from an unusual  
6 circumstance -- an unusual limited unforeseeable  
7 circumstance that occurs, such the estimated tax payment  
8 should be abated.

9 Thank you.

10 JUDGE JOHNSON: This is Judge Johnson. Thank  
11 you.

12 And before we finally wrap up, let me go back to  
13 Judge Tay. If you have one more question, you could ask  
14 that now.

15 JUDGE TAY: Yes. This is Judge Tay. Thank you,  
16 Judge Johnson.

17 I have just one question for FTB. Do you dispute  
18 Appellants' assertion that they could not have known back  
19 in 2016 or prior to April 2017 that they had such a tax  
20 liability?

21 MR. COUTINHO: Respondent doesn't necessarily  
22 refute that Appellant could not have figured it out. But  
23 because there's nothing in the record to affirmatively  
24 show the efforts taken and then the response back that the  
25 information from a CPA or a partnership is not ready or is

1 not able to be calculated, all we can rely upon is the  
2 assertions from Appellants. There's nothing else in the  
3 record. So.

4 While we don't necessarily refute Appellants'  
5 assertion, without anything in the record, we can't say  
6 definitively whether or not their tax liability could have  
7 been determined prior to April 15th.

8 JUDGE TAY: Thank you, Franchise Tax Board. This  
9 is Judge Tay.

10 Judge Johnson, no further questions.

11 JUDGE JOHNSON: This is Judge Johnson. Thank you  
12 very much.

13 So evidence has been admitted into the record.  
14 We have the arguments and your briefs as well as your  
15 testimony and arguments presented today. We now have a  
16 complete record from which to base our decision.

17 Let me ask if there's any final questions before  
18 we close the record.

19 Appellant, any questions?

20 MS. TURANCHIK: None, Your Honor. Thank you.

21 JUDGE JOHNSON: Thank you.

22 And, Respondent, any questions?

23 MR. COUTINHO: This is Brad Coutinho. No  
24 questions. Thank you.

25 JUDGE JOHNSON: Thank you. Judge Johnson again.

1           I wish to thank both parties for their efforts on  
2 appeal. The record is now closed. This will conclude the  
3 hearing on this appeal. Parties should expect a written  
4 decision no later than 100 days from today.

5           With that, we're off the record. This concludes  
6 the hearing in the appeal of Taylor.

7           (Proceedings adjourned at 3:30 p.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne 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 12th day of August, 2020.

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ERNALYN M. ALONZO  
HEARING REPORTER