

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
G. MACDONALD and G. MACDONALD,) OTA NO. 20086498
)
APPELLANT.)
)
)

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Tuesday, December 14, 2021

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 9:32 a.m. and concluding at 9:56 a.m. on
Tuesday, December 14, 2021, reported by
Ernalyn M. Alonzo, Hearing Reporter, in and for
the State of California.

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APPEARANCES:

Panel Lead: ALJ NATASHA RALSTON

Panel Members: ALJ SHERIENE RIDENOUR
ALJ JOSHUA LAMBERT

For the Appellant: STEWART A. FARBER

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PHILLIP C. KLEAM
ELLEN SWAIN

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-3 were received at page 7.)
(Department's Exhibits A-P were received at page 7.)

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California; Tuesday, December 14, 2021

9:32 a.m.

JUDGE RALSTON: We're now on the record in the Appeal of MacDonald.

This matter is being heard before the Office of Tax Appeals. The OTA Case Number is 20086498. Today's date is Tuesday, December 14th, 2021, and the time is approximately 9:32 a.m. This hearing is being conducted electronically with the agreement of the parties.

Today's hearing is being heard by a panel of three administrative law judges. I am Judge Ralston, and I will be the lead judge. Judge Lambert and Judge Ridenour are the other members of this tax appeals panel. All three judges will meet after the hearing and produce a written decision as equal participants. Although as the lead judge I will conduct the hearing, any judge on this panel may ask questions or otherwise participate to ensure that we have all the information needed to decide this appeal.

Also present is our stenographer, Ms. Alonzo.

First, I'm going to ask the parties to introduce themselves for the record. So please state your name for the record, starting with Appellant's representative, Mr. Farber.

1 MR. FARBER: I am Stewart Farber, middle initial
2 A. I'm a certified public accountant in the State of New
3 Jersey and in the State of New York, and I represent the
4 MacDonalds whose income tax return was subjected to a
5 penalty by your lovely state.

6 JUDGE RALSTON: Thank you, Mr. Farber.

7 And for Respondent Franchise Tax Board, please
8 introduce yourselves for the record.

9 MR. KLEAM: Good morning. Phillip Klean on
10 behalf of Franchise Tax Board.

11 MS. SWAIN: Good morning, Panel. My name is
12 Ellen Swain on behalf of the Franchise Tax Board.

13 JUDGE RALSTON: Thank you.

14 So we held a prehearing conference in this
15 matter, and at that conference we discussed that the issue
16 to be decided in this appeal is, have Appellants
17 established reasonable cause for abatement of the
18 late-payment penalty. Let's see. We also discussed at
19 the prehearing conference that there are no -- neither
20 party is going to call any witnesses in this case. And
21 I'm assuming that's still correct, if not, the parties
22 please let me know.

23 As far as exhibits, we discussed at the
24 prehearing conference that Appellants are submitting
25 Exhibits 1 through 3. And Respondent has not raised any

1 objection to those exhibits, and so those exhibits are
2 going to be admitted without objection. Appellant's 1
3 through 3 are admitted without objection.

4 (Appellant's Exhibits 1-3 were received
5 in evidence by the Administrative Law Judge.)

6 We also discussed at the prehearing conference
7 that Respondent has submitted Exhibits A through P, and
8 Appellant has not raised any objections. So Respondent's
9 Exhibits A through P are admitted without objection.

10 (Department's Exhibits A-P were received in
11 evidence by the Administrative Law Judge.)

12 I'm going to check in with the parties. Is that
13 correct?

14 Are those still the exhibits that the parties
15 intend to submit, Mr. Farber.

16 MR. FARBER: Correct from my side.

17 JUDGE RALSTON: Thank you.

18 And Mr. Klean?

19 MR. KLEAM: Yes, ma'am.

20 JUDGE RALSTON: Perfect. Thank you.

21 This hearing is expected to last approximately 60
22 minutes. Appellant will have 20 minutes for their opening
23 presentation. Respondent will have 20 minutes for their
24 opening presentation, and Appellant will have
25 approximately 10 minutes for rebuttal. The panel may ask

1 questions during this time, and I think we are ready to
2 proceed. So does anyone have any questions before we move
3 on to the opening presentations?

4 JUDGE RALSTON: Okay. Mr. Farber, you have 20
5 minutes for your presentation. Please begin when you are
6 ready.

7 MR. FARBER: I'm ready.

8 JUDGE RALSTON: Thank you.

9

10 PRESENTATION

11 MR. FARBER: So, Your Honors, I would like to
12 first thank you on behalf of my clients and the fair state
13 of New Jersey for taking the time to hear this matter.

14 The issue in the case is comparatively simple in
15 my mind. The State of California has imposed an
16 approximate \$36,000 penalty against this taxpayer for
17 nonpayment of an adequate estimated tax for their 2018
18 California nonresident tax return. And there's really
19 only one fundamental issue here, and that is how could the
20 State of California realistically expect the taxpayer to
21 pay a proper estimated tax when the information that was
22 the substance of that estimated tax was not available
23 until September 12th of 2019.

24 I have in my hand a tax return prepared by the
25 prestigious certified public accounting firm of

1 PricewaterhouseCoopers for the subject entity. And it's
2 marked "Initial Return" because the return was actually
3 subjected to corrections. This was an incredibly
4 complicated transaction. The legal fees were in excess of
5 \$1 million is what I was told. There were sales of many,
6 many millions of dollars of properties throughout your
7 wonderful state, and the taxpayer, MacDonald, was a
8 partner in one of the many entities that had an interest
9 in this very large transaction.

10 I can't even remember how many law firms were
11 involved, but it was enormous. So the State has an
12 expectation that somehow the taxpayer was supposed to know
13 before he got his K-1 -- and I'm sure you're all very
14 familiar with the importance of the K-1 -- how this
15 taxpayer could possibly have had any idea what his tax
16 burden was going to be before he got this piece of paper.
17 So, fundamentally, that's our argument, that the State of
18 California has an expectation, apparently, that this
19 taxpayer was supposed to anticipate what the K-1 was going
20 to look like.

21 Now, I could understand the State of California
22 saying, well, if someone sold one piece of real estate and
23 they got a big fat check, that they should anticipate some
24 reasonable tax burden. But this was not that type of a
25 transaction. This was a transaction where there were

1 multimillions of dollars involved, and my client was just
2 one little cog in a massive transaction. And as you all
3 know, Judges, our tax system, including California's, is
4 unbearably complicated. Sometimes in real estate
5 transactions, in order to defer a tax, sellers execute
6 what's called a Section 1031 transfer.

7 My client didn't know whether or not those
8 transactions were occurring. He had no way to know. He
9 was only a minority owner of this massive undertaking.
10 And so it comes to pass, finally, on September 9 --
11 September 12th -- excuse me -- of 2019, he finally gets
12 what is coded as an initial return for an entity that he
13 was a part owner of, in order to first figure out what his
14 personal income tax return was supposed to look like.
15 This was for the year 2018.

16 Now, I can only tell you that in our accounting
17 firm, which was started in 1946, we worked long, long
18 hours to avoid this exact problem, which is the
19 disposition of heavily complicated transactions, informing
20 our clients or the entities that are part owners of their
21 entities, at the last possible second so that they can
22 figure out what their tax liability is going to be. In
23 this particular case, because it was so incredibly
24 complex, no K-1 was available to Mr. MacDonald until
25 September the 12th, 2019.

1 So the State of California, for some reason that
2 I could still not understand, has an expectation or a
3 requirement that these people pay the tax without knowing
4 anything about what the tax would be. I should point out
5 that their taxable income for the years before 2018 were
6 de minimis, well under \$200,000, and in full. They paid
7 taxes to the penny and timely. So I think the State of
8 California should take into consideration the fact that
9 these folks were very conscientious taxpayers for the
10 years that predate this transaction, number one. And they
11 should take into consideration the fact that there was no
12 way for anyone to know what their tax burden was going to
13 be until they received this K-1.

14 That is the substance of our position. Thank you
15 for listening.

16 JUDGE RALSTON: Thank you, Mr. Farber.

17 I'm going to turn to my panel to see if they have
18 any questions.

19 Judge Lambert, do you have any questions.

20 JUDGE LAMBERT: Hi. This is Judge Lambert.

21 Yeah. I guess I was wondering what evidence there is of
22 the sale and its complexities you described in terms of
23 these of the exhibits that we could look at?

24 MR. FARBER: I'm so sorry, Your Honor. I could
25 not hear you.

1 JUDGE LAMBERT: Can you hear me now?

2 MR. FARBER: Yes, I can.

3 JUDGE LAMBERT: I was wondering what evidence or
4 exhibits we can look at to see the sales and its
5 complexities and the other entities involved?

6 MR. FARBER: Well, this is just one of many files
7 that I have on this -- on this transaction. If you
8 require it, I can have my office scan some of the material
9 that we have. And we don't even have all of it. We only
10 have the part that relates to our client. But I will
11 certainly be happy to send to the court whatever it is
12 that you wish in support of my position.

13 JUDGE LAMBERT: Okay. Well, yeah, because I was
14 wondering the effect on -- if it had an effect on any
15 other entities or if they, you know, had the same issues.
16 You know, many times you can issue an estimate K-1. So I
17 was just wondering what kind of complexities that would
18 prevent any kind of estimate and specificity. Like, if
19 you could describe it, you know, especially with that
20 amount of gain.

21 MR. FARBER: Well, Your Honor, in response I'm
22 going to tell you that I have another client with this
23 exact same case, exact same facts. The Court has not
24 rendered a decision as of yet. We were -- went through
25 this exact same procedure several months ago. I don't

1 recall when.

2 And so there's at least one other person that I
3 know who had this problem, but I'm sure there are many
4 more. But I will -- I'm making notes, and if someone
5 would give me where to send it, I will send what I have in
6 my file to demonstrate the complexity of the transaction,
7 all the law firms that were involved, all the massive
8 amounts of money that was involved in this transaction.
9 But I don't have it in front of me at the moment, Your
10 Honor.

11 JUDGE RALSTON: Judge Lambert, we did not hear if
12 you just spoke.

13 We are still having a problem hearing you,
14 Judge Lambert.

15 Okay. Thank you, Mr. Farber.

16 Judge Ridenour, did you have any questions for
17 Mr. Farber?

18 JUDGE RIDENOUR: Yes, actually I do. Thank you
19 so much.

20 Mr. Farber, I understand you are indicating that
21 your clients are unable to estimate their income based on
22 the schedule K-1. However, according to the federal
23 transcripts, it does appear that your clients had W-2's
24 and 1099s and other wage income information to which they
25 would be able to file at least one return on time and then

1 be able to file an amended return after they receive the
2 other information. So my question is why your clients did
3 not go that route?

4 MR. FARBER: Your Honor, I'm so sorry. Can you
5 explain again what you mean by -- go what route would that
6 be?

7 JUDGE RIDENOUR: To file a return -- a timely
8 return with the 1099 and W-2 wage information that they
9 had, and then, after they received the other information,
10 to file an amended return.

11 MR. FARBER: I see. Well, Your Honor, first of
12 all, the taxpayers filed an extension for their 2018
13 income tax return, both with the IRS and the State of
14 California. Their only other income were W-2 forms, for
15 which the taxes were fully withheld, and some very
16 minimal -- some very minimal small amounts of interest or
17 dividends. But the magnitude of those numbers compared to
18 this K-1 is incredibly small. I think that the W-2 forms
19 were -- I don't really remember exactly -- but they were
20 maybe one-tenth the size of these K-1s.

21 And, Your Honor, the taxpayers did pay estimated
22 taxes, I believe at least for the year 2018, to the extent
23 that they were required to. But certainly the W-2 forms
24 had all the withholding that was required to be fully
25 paid. So there were no additional tax due on their W-2's

1 or on their 1099s. The only thing that created an
2 incremental tax was the K-1, which they did not get until
3 the date that I reflected earlier in September of 2019.

4 JUDGE RIDENOUR: Okay. Thank you very much.

5 MR. FARBER: You're welcome.

6 JUDGE RIDENOUR: No further questions.

7 JUDGE RALSTON: Thank you, Judge Ridenour.

8 Mr. Kleam, you have 20 minutes for your
9 presentation. Please begin when you are ready.

10 MR. KLEAM: Thank you very much.

11

12 PRESENTATION

13 MR. KLEAM: Good morning again. And, again, my
14 name is Phillip Kleam, and with me is Ellen Swain, and we
15 represent Respondent Franchise Tax Board.

16 So Mr. and Mrs. MacDonald timely filed their 2018
17 California tax return by the automatic extension to file
18 date on October 11th, 2019. But the problem is that they
19 also paid their 2018 tax liability on October 11th, 2019.
20 And an extension to time to file is not an extension to
21 time to pay the tax, which must be fully paid on or before
22 the original date of the return, which is here,
23 April 15th, 2019. So the late payment penalty was
24 properly imposed. And as you stated earlier, the issue is
25 whether Appellants have shown reasonable cause to abate

1 the penalty.

2 Now, in order to establish reasonable cause,
3 Appellants must show that the failure to timely pay the
4 amount shown on the return occurred despite the exercise
5 of ordinary business care and prudence. And to show this,
6 Appellants must show credible and competent evidence to
7 support their claim. They just have not done this. They
8 have not shown that they exercised ordinary business care
9 and have not provided sufficient evidence, if any, to
10 support their claim of reasonable cause.

11 The only argument that they have made in support
12 of their claim is that they did not receive their K-1s in
13 time to pay their taxes due by April 15th. But an
14 inability to timely pay tax because lack of necessary
15 documents does not by itself establish reasonable cause.
16 They must show that they could not have acquired the
17 information necessary to estimate the tax liability.
18 Appellants have not done this.

19 Other than stating that the K-1s were not
20 available, they have not provided any evidence that they
21 made an attempt to acquire the information before the
22 payment due date. From the OTA's precedential decision in
23 the Moran Opinion, unsupported evidence -- and this is a
24 quote -- "unsupported assertions that records were
25 difficult to obtain without any substantiation of the

1 efforts to retrieve those documents is not sufficient to
2 show reasonable cause."

3 Now, I hear Mr. Farber saying, you know, this
4 is -- you know, this was an incredibly complex
5 transaction. There's no way for them to know what their
6 tax burden was going to be before the K-1s. You know,
7 they -- they work long hours to avoid this particular
8 problem because it's so complex and there's lots of law
9 firms involved and million dollars in attorneys' fees.
10 That's fine, but they need to show us that because right
11 now they haven't given us anything. All we have is
12 repeated assertions that this was very complex. There has
13 been no substantiation of the efforts to retrieve these
14 documents.

15 I know Mr. Farber stated that, you know,
16 Mr. MacDonald is a bit player in this overall thing, but
17 he is an experienced real estate investor and a 50 percent
18 partner in many of the partnerships involved. And they
19 just haven't shown that they made any effort to obtain the
20 information necessary to calculate their tax due. If it
21 is incredibly complex, then they need to show us. Because
22 right now we have nothing but an unsupported assertion
23 that the documents were not available. Which again from
24 Moran, is insufficient to show reasonable cause.

25 Since Appellants have not provided any evidence

1 that they attempted to obtain the information necessary to
2 pay their taxes, and since simply not having the
3 information is insufficient, Appellants have not shown
4 that they are entitled to reasonable cause abatement of
5 the late-payment penalty.

6 Thank you.

7 JUDGE RALSTON: Thank you, Mr. Kleam.

8 Judge Lambert, do you have any questions for
9 Mr. Kleam?

10 JUDGE LAMBERT: I have no questions. Thanks.

11 JUDGE RALSTON: Thank you.

12 Judge Ridenour, did you have any questions?

13 JUDGE RIDENOUR: This is Judge Ridenour. I do
14 not. Thank you very much.

15 JUDGE RALSTON: Thank you.

16 Okay. Mr. Farber, you have five minutes for your
17 rebuttal. Please remember to unmute yourself using the
18 microphone icon on the bottom of your screen.

19

20 CLOSING STATEMENT

21 MR. FARBER: Well my only comment is with respect
22 to the informed gentleman from the State of California is,
23 I don't know how you go about contacting
24 PricewaterhouseCoopers to ask them for preliminary
25 information on its sale of properties when they themselves

1 don't know until they do the K-1. I mean, it seems to me
2 that the absence of a K-1 until September the 12th, 2019,
3 is prima facie documentation that these people couldn't
4 possibly file a proper estimated tax.

5 It sounds to me like the gentleman from
6 California expects the client to satisfy this rule that
7 you have to demonstrate that you've attempted to get the
8 information. Well, what does that really mean in the
9 situation where you're a tax -- or you're a partner in a
10 transaction of multimillions of dollars and the accounting
11 firm that's responsible for handling it, they themselves
12 don't know until they file the return. So to me that's
13 automatic documentation onto itself that these people
14 couldn't possibly have filed a meaningful and accurate
15 estimated tax on this transaction without the K-1.

16 Now, if -- if what's expected -- if the
17 California statutes require that a taxpayer in your state
18 verify with letters and phone calls and whatever to show
19 that they contacted the accountant who is supposed to
20 issue the K-1 for some sense of what the numbers are, well
21 then, we lose because we didn't do that. We relied upon
22 the simple date on the K-1, which is September 12th, 2019.

23 And, Your Honors, I think what the State of
24 California is asking of this taxpayer is absurd. You
25 can't just call up PricewaterhouseCoopers and say that

1 you're anxious about meeting your estimated tax
2 requirement. PricewaterhouseCoopers was drowning, most
3 likely, in trying to get these tax returns done by
4 September 12th. So for the tax -- for the State of
5 California to set a standard of behavior such that the
6 State expects people to contact the accountant for a
7 company and ask them for the data so that they can
8 properly file their estimated tax, to me, is really
9 pushing a burden on the taxpayer that is really
10 unreasonable.

11 That's all I can possibly say.

12 JUDGE RALSTON: Thank you, Mr. Farber.

13 Judge Lambert, did you have any questions?

14 JUDGE LAMBERT: I have no questions. Thanks.

15 JUDGE RALSTON: Thank you.

16 Judge Ridenour, did you have any questions?

17 JUDGE RIDENOUR: This is Judge Ridenour. I do
18 not. Thank you very much.

19 JUDGE RALSTON: Okay. We are ready to conclude
20 this hearing. This case is submitted on December 14th,
21 2021, at 9:56 a.m. Today's hearing in the appeal of
22 MacDonald is now adjourned, and the record is closed. The
23 next hearing will resume sat 1:00 p.m. Thank you everyone.

24 Thank you for coming in. The judges will meet
25 and decide your case later on, and we will send you a

1 written opinion of our decision within 100 days after the
2 record is closed -- or within 100 days from today.

3 Thank you.

4 (Proceedings adjourned at 9:56 a.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 29th day
of December, 2021.

ERNALYN M. ALONZO
HEARING REPORTER