

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
RED VISION SYSTEMS, INC.,) OTA NO. 18124068
)
 APPELLANT.)
)
)

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Tuesday, April 26, 2022

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 11:00 a.m. and concluding at 12:07 p.m.
on Tuesday, April 26, 2022, reported by
Ernalyn M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: ALJ RICHARD TAY

Panel Members: ALJ ELLIOTT SCOTT EWING
ALJ CHERYL AKIN

For the Appellant: PATRICK T. CONNOLLY
STAN TARBELL

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

LEOANGELO CRISTOBAL
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 6.)
(Department's Exhibits A-D were received at page 6.)

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California; Tuesday, April 26, 2022

11:00 a.m.

JUDGE TAY: We're opening the record in the Appeal of Red Visions Systems, Inc., before the Office of Tax Appeals, Case Number 18124068. This hearing being convened virtually on April 26, 2022. The time is right around 11:00 a.m.

Today's case is being heard and decided equally by a panel of three judges. My name is Richard Tay, and I will be acting as the lead judge for the purposes of conducting this hearing. Also, on the panel with me today are Judges Cheryl Akin and Elliott Scott Ewing.

Will the parties introduce themselves for the record, beginning with Appellant.

MR. TARBELL: Stan Tarbell, vice president of tax.

MR. CONNOLLY: Patrick Connolly, director of tax, First American.

MR. CRISTOBAL: Leo Cristobal representing Franchise Tax Board.

MS. BROSTERHOUS: Maria Brosterhous of Franchise Tax Board.

JUDGE TAY: Thank you.

The issue we will discuss today is whether

1 Appellant has shown that Franchise Tax Board erred in
2 assessing the late-payment penalty for the tax year ending
3 September 20th, 2016.

4 Prior to the hearing we circulated exhibits
5 submitted by both parties in a file we call a hearing
6 binder. It contains Appellant's Exhibits 1 through 6 and
7 Respondent's Exhibits A through D. There were no
8 objections to admitting the exhibits into evidence. And
9 so the exhibits will now be admitted into the record.

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

12 (Department's Exhibits A-D were received in
13 evidence by the Administrative Law Judge.)

14 I'd like to start with the presentations and
15 starting with the Appellant.

16 Appellant, you have 15 minutes. Please begin
17 when you are ready.

18
19 PRESENTATION

20 MR. CONNOLLY: Thank you, Your Honor.

21 Your Honors, thank you for your time today.

22 As discussed in the preliminary hearing, this
23 hearing does not involve a dispute of the facts but,
24 rather, a disagreement on the application of California's
25 Penalty Provision under Section 19132 of the Revenue and

1 Taxation Code for a failure to pay tax by the original due
2 date of a taxpayer's California tax return.

3 As noted by both parties, Section 130 -- 19132
4 provides an exception to this penalty if the taxpayer can
5 show a failure is due to reasonable cause and not due to
6 willful neglect. The primary source of disagreement here
7 is how to apply this reasonable cause exception. The
8 Franchise Tax Board or the FTB argues that the federal
9 Treasury Regulations under Internal Revenue Code or IRC
10 Sections 6651, which imposes a penalty for a failure to
11 pay tax by the original due date controls how to interpret
12 the Reasonable Cause Provision in Section 19132.

13 We believe because California's legislature
14 enacted its own penalty provision for a failure to pay tax
15 by the original due date, Section 19132, it is only for
16 California's legislature and courts to interpret that
17 penalty provision. The primary source for the confusion
18 in this matter appears to be rooted in the identical
19 language in both the federal and California provisions
20 used in exempting the application of the penalty, i.e.,
21 that the taxpayer show that the failure is due to
22 reasonable cause and not due to willful neglect.

23 While California does conform tax law -- its tax
24 law to the IRC in a number of areas, as stated by the FTB
25 in its summary of federal income tax changes 2016 -- and

1 I'm quoting, "California does not conform by reference to
2 IRC Section 6651 relating to a failure to file tax
3 return -- a tax return or to pay tax but, instead, has
4 stand-alone language that parallels the federal provision.
5 California law provides that a taxpayer who fails to file
6 a tax return on a timely basis is subject to a penalty
7 equal to 5 percent of the net amount of tax due for each
8 month that the return is not filed up to a maximum of 5
9 months or 25 percent.

10 "An exception from the penalty applies if the
11 failure is due to reasonable cause. The net amount of tax
12 due is the excess of the amount of the tax required to be
13 shown in the return over the amount of any tax paid on or
14 before the due date prescribed for the payment of tax,"
15 end quote.

16 Therefore, while California's stand-alone
17 language parallels the federal penalty provision,
18 California has chosen not to conform to the IRC with
19 respect to the imposition of penalties for a failure to
20 pay tax by the original due date. Consequentially, it is
21 for California's legislature and courts and not the
22 federal Treasury Department.

23 To interpret California's penalty provision, the
24 federal Treasury Regulations interpreting federal
25 penalty -- the federal penalty provision for a failure to

1 pay tax by the original due date, Section 5651, is neither
2 instructive nor relevant to interpreting California's
3 penalty provision for a failure to pay tax by the original
4 due date, Section 19132.

5 With that in mind, we turn our attention to
6 California Section 19132, penalty for a failure to pay tax
7 by the original due date and the interpretation of that
8 provision by California's legislature and courts. As
9 noted above, Section 19132 provides the taxpayers with an
10 exception from its penalty for failure to pay tax by the
11 original due date, if the taxpayer is able to show the
12 failure is due to reasonable cause and not due to willful
13 neglect.

14 As both parties in this appeal, the Office of Tax
15 Appeals has provided -- excuse me -- as noted by both
16 parties in this appeal, the Office of Tax Appeals has
17 provided guidance on a limited number of occasions on how
18 the reasonable cause exception in Section 19132 should be
19 interpreted. In Appeal of Michael Scanlon and Devon, the
20 Office of Tax Appeals stated that in order to establish
21 reasonable cause for a late payment of tax, a taxpayer
22 must show that his or her failure to make a timely payment
23 of the proper amount of tax occurred despite the exercise
24 of ordinary business care and prudence.

25 This ordinary business care and prudence standard

1 established by the OTA is the standard we have applied to
2 evaluate our situation, and conclude we have shown
3 reasonable cause for our failure to pay tax by the
4 original due date, and that the failure was not due to
5 willful neglect. As we have noted to the FTB, our failure
6 to pay tax by the original due date was a result of our
7 exercise of ordinary business care and reasonable
8 prudence.

9 As shown in the timeline that we have provided,
10 IRC Section 338, to which California conforms, provides
11 taxpayers with eight-and-one-half months after a
12 qualifying stock purchase of a corporation to file an IRC
13 Section 338 election. It is during this period of time
14 that the taxpayer performs the due diligence required to
15 exercise ordinary business care and reasonable prudence to
16 assess whether the filing of an IRC Section 338 election
17 is appropriate.

18 The due diligence typically involves the review
19 of past tax returns filed by the acquired corporation,
20 evaluation of any net operating loss carry forwards
21 calculated and reported by the acquired corporation on
22 those tax returns, as well as financial modeling and
23 evaluation of whether the future tax benefit filing an IRC
24 Section 338 election, i.e., those benefits, for example,
25 being future tax depreciation and amortization deductions

1 due to the election resetting the acquired corporation's
2 assets to fair market value.

3 All of this we have to determine as to whether
4 the election is in the best interest of the acquiring
5 corporation. As noted in the timeline, we completed our
6 exercise of ordinary business care and reasonable prudence
7 and filed our IRC Section 338 election on June 5th, 2017.
8 While this was approximately five months after Red Vision
9 Systems' original due date to file its short-year tax
10 return, i.e., January 17, 2017, it was within the
11 eight-and-one-half months provided by IRC Section 338,
12 which was June 15, 2017.

13 The timeline of steps we took to, one, perform
14 the necessary due diligence to assess whether the filing
15 of the IRC Section 338 the election was appropriate; two,
16 preparing and filing the Red Vision Systems' federal tax
17 return; and three, preparing and filing the Red Vision
18 Systems' California tax return and payment of the
19 California tax due on that return, is consistent with the
20 ordinary business care and reasonable prudence standard
21 established by the OTA to satisfy the reasonable cause
22 exception in Section 19132.

23 As noted in the timeline, we concluded our due
24 diligence as to whether an IRC Section 338 election was
25 appropriate and filed that Section 338 election on

1 June 5, 2017, well before the June 15th, deadline to
2 conclude that due diligence and file that IRC Section 338
3 election. We then expedited the preparation of Red Vision
4 Systems' federal tax return and filed that tax return just
5 eight days later on June 13, 2017.

6 That then allowed us to expedite the preparation
7 of the California tax calculations and the California tax
8 return, which we filed just nine days later on
9 June 22, 2017. Due to a minor administrative delay,
10 further exacerbated by the 4th of July occurring on
11 Tuesday that year, our payment of the California tax due
12 was sent by check via the U.S. Postal Service on
13 July 5th, 2017. We believe the exercise of ordinary
14 business care and reasonable prudence that we exhibited in
15 the due diligence that we have performed to determine
16 whether the IRC 338 election was appropriate, the
17 expedited preparation and filing of Red Vision Systems'
18 federal tax return, and the expedited preparation and
19 filing of Red Vision Systems' California tax return and
20 payment of the California tax, is consistent with the
21 OTA's ordinary business care and reasonable prudence
22 standard required to satisfy the Reasonable Cause Section
23 exception in Section 19132.

24 Consequently, we believe our failure to pay Red
25 Vision Systems' California tax by the original due date

1 January 17, 2017, was due to reasonable cause and not due
2 to willful neglect and, therefore, Red Vision Systems
3 qualifies for the exception for the failure to pay a tax
4 penalty under Section 19132. Accordingly, we respectfully
5 request abatement of the penalty assessed by the FTB.

6 Thank you.

7 JUDGE TAY: Thank you, Mr. Connolly.

8 Before we move on to Franchise Tax Board's
9 presentation, I'm going to turn to my panel to see if they
10 have any questions.

11 Judge Akin, do you have any questions for
12 Appellant?

13 JUDGE AKIN: Judge Akin speaking. Yes, I do have
14 one question I'd like to ask. You know, I noted that you
15 said that the election was filed on July -- June 15th --
16 June 5th; is that correct?

17 MR. CONNOLLY: That's right, Your Honor.

18 JUDGE AKIN: Okay. And I guess I'm just
19 wondering if Red Vision or First American Financial knew
20 that they were planning on making that election before,
21 you know, it was actually filed and what the time frame
22 around that decision was -- when it was made.

23 MR. CONNOLLY: I understand. I'll first give
24 Stan an opportunity to respond and, if not, I can respond.

25 MR. TARBELL: Oh, sure. I can chime in. As the

1 chief tax officer, it's part of my responsibility to
2 oversee the filing of all of our returns and the positions
3 we take on those tax returns, which include things like a
4 Section 338 election. And Patrick was instrumental in the
5 calculations and the due diligence, as he outlined, in
6 coming up with that. So until we work through those
7 calculations, we don't know whether we intend to make the
8 election, which is, you know, why Section 338 allowed the
9 eight-and-a-half months because they are complex
10 calculations and they take a while to work through.

11 And so we share with our acquisition partners
12 that we may or may not be filing a 338 election depending
13 on which election we're filing. But we don't promise
14 anything at the acquisition date. That's dependent upon
15 our own research and due diligence.

16 JUDGE AKIN: Okay. Thank you. Just one
17 additional follow-up question. Since, you know, part of
18 that due diligence requires, you know, all of the
19 computations that you're noting to, you know, evaluate
20 whether or not it's going to be favorable to file that
21 election. I guess I'm wondering if there was any way for
22 the taxpayer to know or estimate their California tax and
23 pay it, you know, around that time the election was made;
24 so around, you know, the June 5th decision time frame.

25 MR. TARBELL: Patrick may have more color around

1 this, but from my perspective, no. Because, again, once
2 we determine federal is favorable, we have any number of
3 state returns that we also have to look at; California
4 being one of those, but there are a number of them. So we
5 have to look at the whole package and determine whether
6 this is going to be filed. Some states follow the Feds,
7 and some states don't. So we have to take all of that
8 into consideration. So I think the general answer would
9 be no.

10 But Patrick, did you have anything to add?

11 MR. CONNOLLY: Yeah. I believe that uncertainty,
12 that process that we have to pursue, the multiple states
13 that we have to look at, the federal calculation in and of
14 itself to get us to the taxable income, to get us to
15 California taxable income, all of those things are in play
16 and take time. So I agree with Stan's comments.

17 JUDGE AKIN: Okay. Thank you. Judge Akin
18 speaking here. I don't have any additional questions at
19 this time.

20 JUDGE TAY: Thank you.

21 Judge Ewing, do you have any questions for
22 Appellant?

23 JUDGE EWING: No, Judge Tay. I was going to ask
24 about the estimated tax payments, but Judge Akin asked
25 those, and they were answered. Thank you.

1 JUDGE TAY: Thank you, Judge Ewing.

2 I have one question for Appellant, so I guess one
3 clarification question. Now, before making the 338(g)
4 election, Red Vision would have been required to file and
5 pay tax on what date, if you had not made a 338(g)
6 election in June?

7 MR. TARBELL: That would be January 17th, of
8 2017. Although, I would note there would be no tax due
9 because they had operating loss apart from the 338 being
10 gained.

11 JUDGE TAY: Okay. Was any return prepared in
12 anticipation of not making the 338(g) election?

13 MR. TARBELL: I'm not sure I follow. We didn't
14 prepare a return. We filed an extension because we were
15 looking into the 338 election.

16 JUDGE TAY: I see. Yeah. I see that in your
17 timeline that you filed an extension on December 13th,
18 which would have been before the -- I guess, the return
19 was due. And an extension, when would that return have
20 been due?

21 MR. TARBELL: That's in the timeline right,
22 Patrick?

23 MR. CONNOLLY: Yes, yes. Then the return for the
24 federal was July 17th, 2017.

25 MR. TARBELL: That was for the State right,

1 Patrick?

2 MR. CONNOLLY: In California as well. Yeah.
3 Yeah, federal and California.

4 JUDGE TAY: Okay. Just to be clear, if Red
5 Vision had not made a 338(g) election, the return of the
6 payment -- I'm sorry -- the return would have been due by
7 July 17th, 2017, and there would have been no payment due
8 because there was an operating loss for that year?

9 MR. CONNOLLY: Correct.

10 MR. TARBELL: That's correct.

11 JUDGE TAY: Okay. Thank you for clarifying that.
12 I have no further questions.

13 And so I will turn to Respondent Franchise Tax
14 Board and allow them to make their presentation.

15 You have 15 minutes. Please begin when you're
16 ready.

17

18 PRESENTATION

19 MR. CRISTOBAL: Thank you, Judge. Good morning.
20 My name is Leo Cristobal, and I'm tax counsel for
21 Respondent Franchise Tax Board. And with me is Maria
22 Brosterhous, also tax counsel for Respondent.

23 The issue in this case is whether Appellant met
24 its burden of proof to establish reasonable cause to abate
25 the late-payment penalty. As aforementioned, the

1 Appellant had tax year ending September 20, 2017.
2 California law provides that a corporation must file a tax
3 return by the 15th day of the fourth month following the
4 close of a fiscal year. And while California grants an
5 automatic six-month extension of time to file the return,
6 Revenue & Taxation Code Section 19001 requires taxpayers
7 to pay their tax liability at the time for filing their
8 tax return without regard to extensions. Therefore, the
9 due date for Appellant's California return and California
10 tax was January 15th, 2017. In that year the 15th fell on
11 a Sunday, so January 17th, 2017.

12 Now, Appellant filed its California return on
13 June 22nd, 2017, which was considered timely pursuant to
14 the automatic six-month filing extension. However,
15 Appellant did not pay its tax until July 5th, 2017. The
16 fact the payment was made late, six months after the
17 January 2017 due date pay, is undisputed. In a situation
18 like this, when a taxpayer fails to pay its tax on time,
19 Respondent must impose a late-payment penalty pursuant to
20 Revenue & Taxation Code Section 19132.

21 In order to overcome the presumption that the
22 late-payment penalty was imposed correctly, a taxpayer
23 must establish that the failure to pay on time was due to
24 reasonable cause and not due to willful neglect. To
25 establish reasonable cause, a taxpayer must show that the

1 failure to pay timely occurred despite the exercise of
2 ordinary business care and prudence. The reason for
3 missing the deadline must be such that an ordinarily
4 intelligent and prudent businessperson would have acted
5 similarly under the circumstances.

6 First, as Appellant has already explained,
7 California conforms to Internal Revenue Code Section 338.
8 And as it relates to the late-payment penalty at issue in
9 this appeal, Appellant could have obtained a waiver of
10 this penalty, if Appellant had paid its California tax by
11 the same deadline to make a 338 election. There is no
12 dispute that Appellant made a timely 338 election.
13 However, Appellant did not pay its California tax within
14 this same time frame. Therefore, it's also undisputed
15 that Appellant does not qualify for a waiver of the
16 late-payment penalty, which was a remedy specifically
17 provided under Internal Revenue Code Section 338.

18 Now, despite the failure to meet the 338 -waiver
19 requirement, Appellant contends that it has still been
20 able to demonstrate the type of reasonable cause that is
21 necessary to abate the late-payment penalty under
22 Revenue & Taxation Code Section 19132. Appellant argues
23 that it needed time to perform due diligence in deciding
24 whether to make an election. Additionally,
25 notwithstanding Appellant's ability to pay its federal tax

1 in time to obtain a federal waiver of the federal
2 late-payment penalty, Appellant argues that it needed
3 additional time to figure out and pay its California tax.

4 Based on the facts of this case, a businessperson
5 exercising ordinary care and prudence in the same
6 situation as Appellant would have complied with all of the
7 requirements of the aforementioned waiver provision before
8 the eight-and-a-half month waiver period had lapsed. That
9 is to say an ordinarily intelligent and prudent business
10 person would have made sure to pay its California tax by
11 June 15th, 2017, in order to obtain a waiver of the
12 California late-payment penalty, just as it had done on
13 the federal level with the federal tax and the federal
14 penalty.

15 However, that is not what Appellants did in this
16 case. Moreover, despite Appellant's argument that it was
17 faced with various adjustments effecting the calculation
18 of California taxable income as well as multiple state and
19 local filing obligations and administrative delays, it has
20 been well established that difficulty in determining
21 income with exactitude or complexity of the tax law in
22 computing tax liability is not reasonable cause.
23 Consequently, a taxpayer relying on these arguments cannot
24 demonstrate reasonable cause for paying their tax late.

25 In conclusion, there's no dispute as to the facts

1 of this case. This is just a question of law. Under
2 Revenue & Taxation Code Section 19001, Appellant's tax was
3 due January 17th, 2017, but they paid late on
4 July 5th, 2017. Respondent correctly assessed the
5 mandatory late-payment penalty under Revenue & Taxation
6 Code Section 19132, and Appellant has not met its burden
7 of proof to establish that the late-payment penalty was
8 due -- that its late payment -- excuse me -- was due to
9 reasonable cause. Accordingly, Respondent's action should
10 be sustained.

11 Thank you. And I am happy to answer any
12 questions you may have at this time.

13 JUDGE TAY: Thank you, Mr. Cristobal.

14 I'm going to turn to my panelist first to see if
15 they have any questions for Respondent.

16 Judge Akin, any questions for Franchise Tax
17 Board?

18 JUDGE AKIN: Judge Akin speaking. I do have one
19 question for Franchise Tax Board. I just want a
20 clarification. Is it Franchise Tax Board's position that
21 in a situation such as this where an IRC Section 338(g)
22 election is made that the only way to abate the penalty
23 would be to meet the requirements of Treasury Regulation
24 1.338-10(b), or, you know, are -- assuming taxpayer does
25 not meet those requirements, is there a possibility they

1 can establish reasonable cause, you know, traditionally?

2 MR. CRISTOBAL: Yes. Thank you, Judge. So yes.
3 Under RTC 199132, in order to abate the penalty under that
4 provision, it is by showing a reasonable cause. Now,
5 separately under the 338(g)-waiver provision, the
6 penalty -- if those requirements are met to get a waiver,
7 the penalty is not being abated under 19132. It's being
8 waived under that specific provision.

9 So the failure to obtain a waiver under 338 does
10 not necessarily preclude an abatement under 19132 with an
11 adequate showing of reasonable cause, Respondent Franchise
12 Tax Board is simply arguing -- or not simply arguing, but
13 to clarify, we are arguing that both have not been met.
14 There has not been a waiver under 338(g), which is not in
15 dispute at this time. We are also saying that there is
16 no -- there has not been adequate showing of reasonable
17 cause under 19132.

18 JUDGE AKIN: Thank you. That answers my
19 question.

20 JUDGE TAY: Thank you.

21 Judge Ewing, any questions for Franchise Tax
22 Board?

23 JUDGE EWING: Thank you, Judge Tay. No, I do not
24 have any questions. Thank you.

25 JUDGE TAY: I have no questions for Respondent at

1 this time.

2 And so I will allow Appellant five minutes on
3 rebuttal. And so please feel free to proceed when you're
4 ready.

5 MR. TARBELL: Patrick, I'll defer to you first,
6 and maybe I'll chime in later.

7 JUDGE TAY: Mr. Connolly, I apologize, but you
8 are on mute still.

9 MR. CONNOLLY: Thank you. And Stan, I'll try to
10 give you a couple minutes on the back end.

11

12 CLOSING STATEMENT

13 MR. CONNOLLY: So what we've heard from the FTB
14 are two things that we fundamentally disagree upon. The
15 first one is that their view is that a federal Treasury
16 Regulation that provides relief under the federal penalty
17 for payment of tax late, applies to interpreting
18 California's penalty for a failure to pay tax on time.
19 While what I believe the source of confusion here is that
20 the Treasury Department conveniently placed this
21 reasonable cause and a payment -- a mitigation payment by
22 the date of the election -- due date of election.

23 They place that under the Section 338 code
24 section, so they numerated it 1.338-10, but it's
25 explaining. It's providing guidance to when there is a

1 waiver of the penalty under the federal 6651 penalty for a
2 payment of tax. So on that particular point, the 338-10
3 reg, it's irrelevant. It doesn't apply. It does not
4 apply. It looks like it applies because 338 is something
5 that California has conformed with, but the regulation
6 speaks to the penalties that would apply but for
7 conforming under this regulation. So it's a mismatch.
8 It's a mismatch. So California has no connection with
9 this regulation.

10 And, secondly, from a reasonable person
11 perspective, the ordinary business care and prudence
12 standard, the idea that we would be able to calculate and
13 pay on the exact due date where we are allowed from a
14 federal perspective to make a reasonable decision on
15 whether to file this election does not make sense. If
16 Congress believes that -- that under the ordinary or
17 business care standard that it takes that much amount of
18 time, eight-and-one-half months, to assess whether to make
19 the election, how could we possibly calculate and pay the
20 California tax on that same date?

21 So that's -- our view is that once we made that
22 decision as permitted under the timeline -- and we used a
23 shorter amount of timeline given by the federal 338
24 election -- we immediately proceeded to calculating the
25 federal tax return calculation, which then enabled us to

1 then calculate the California. It wasn't that the
2 California tax was complex. These are just processes.
3 These are processes, and we follow the processes.

4 So the only question in our mind is whether it's
5 1 day, 7 days, 9 days. How many days is reasonable? As
6 you can see from our position, we believe the minimal
7 amount of days that we used to file and pay the California
8 tax is well within the intent of the reasonable cause
9 exception elaborated and defined by the OTA.

10 And I may have used our time.

11 MR. TARBELL: Do we have another minute perhaps,
12 Judge Tay?

13 JUDGE TAY: Sure, I can allow a minute or so, if
14 you would like to add anything.

15 MR. TARBELL: Yes. Thank you. Just a couple of
16 points. There is, I guess, a subjective element in terms
17 of defining reasonable and ordinary care and so on. I
18 think Patrick has done a good job of outlining how we
19 contemplate that. And then the objectively factor might
20 be more the rule of law, the way 338 is conformed to by
21 California and the regulation they are under, except where
22 that conformity is explicitly disavowed as in the quote
23 that Mr. Connolly read in his presentation, that with
24 respect to the penalty provisions that are referred to in
25 the 1.338-10 reg over to Section 6651 of the Internal

1 Revenue Code.

2 California says that's where we draw the line.
3 We don't follow that. We go to Section 19132, which
4 includes the same reasonable cause language as does the
5 federal but not the corrective action provision as in
6 the dash-10 regulation.

7 Thank you.

8 JUDGE TAY: Thank you, Mr. Tarbell.

9 I will again turn to my panelist to see if they
10 have questions for either party. I will turn to Judge
11 Akin first.

12 Judge Akin, any questions?

13 JUDGE AKIN: Judge Akin speaking. I do have one
14 question I want to pose to Franchise Tax Board, which is
15 maybe they could explain why it is Franchise Tax Board
16 believes they conform to the Treasury Regulation 1.338-10?

17 MR. CRISTOBAL: Thank you, Judge. So just to
18 clarify the question, is it -- are you asking why
19 Franchise Tax Board conforms to the regulation, or why it
20 would be controlling in a situation involving a 338
21 election?

22 JUDGE AKIN: Yes. Let me clarify. I'm wondering
23 why it is Franchise Tax Board conforms and what bearing,
24 if any, is there, you know, based on the fact that it's in
25 the regulation under the 338 election as opposed to a, you

1 know, Treasury Regulation that would be discussing the
2 late payment penalty. I don't recall the IRC section for
3 that.

4 MR. CRISTOBAL: Right. So Franchise Tax Board
5 would follow the 338 regulation that, you know, the
6 regulation explaining the actual Internal Revenue Code
7 section, because Franchise Tax Board conforms to the
8 actual federal code section. So since we conform to the
9 primary source of the law, which is the code section, we
10 would follow the guidance provided by the regulation.

11 I do want to point out that as it's been said a
12 few times that the Franchise Tax Board -- I don't believe
13 there's a dispute about the waiver provision. We -- our
14 argument is that Appellant has not met the reasonable
15 cause standard in Revenue & Taxation Code 19132. I just
16 want to point that out for the record.

17 JUDGE AKIN: Understand. One additional
18 follow-up question. Had that regulation, instead of being
19 under 338, instead had been under the IRC section relating
20 to federal late-payment penalty, would Franchise Tax Board
21 still conform to that?

22 MR. CRISTOBAL: I think I need another -- I need
23 to clarify the question. Is the question if the specific
24 regulation fell under the federal late-payment penalty,
25 you know, getting guidance on how to abate the federal

1 late-payment penalty? Okay.

2 And then so if -- if California conformed to that
3 federal statute for the late-payment penalty, then any
4 guidance provided by a regulation would be appropriate
5 guidance for the Franchise Tax Board in that scenario.
6 However, again, as it stands now, we do have a specific
7 code section in the Revenue & Taxation Code. So we would
8 simply follow that code section along with precedential
9 Office of Tax Appeals case law.

10 JUDGE AKIN: Okay. Understood. I think that
11 addresses my question. Thank you.

12 And one additional follow-up question for
13 Appellant. Just going to when the payment at the
14 California tax was made, you know, I note that you've
15 indicated that it was mailed on July 5th. I guess I'm
16 just wondering why it wasn't mailed earlier, perhaps on --
17 I think it was June 22nd when the California return was
18 filed? The California return?

19 MR. TARBELL: Go ahead, Patrick. You're muted.

20 MR. CONNOLLY: Yes. Thank you. And thank you
21 for the question, Your Honor.

22 Yeah. Look, the process of writing a check for
23 any corporation, there's a process to having that check
24 written. There's a department that does that, and then
25 issuing the check where it needs to go, that takes a

1 little time. Not that it takes weeks, but it takes a
2 little time. And unfortunately -- unfortunately,
3 July 5th -- July 4th was right on the heels of that
4 process.

5 So while the check may have been available, may
6 have been written, or about to be available, we all of a
7 sudden had people obviously on it -- on that, a little bit
8 of an extended holiday. Again, July 4th is on the
9 Tuesday. So the normal Saturday, Sunday, Monday, Tuesday
10 would have been your typical time off. And so it was
11 just -- it wasn't -- it wasn't for sitting on it. It was
12 just a matter of just the normal process of getting a
13 check request in, getting the check written, and getting
14 the check over. Because it's a physical thing that has to
15 be given to us, and then we place it in the U.S. Parcel
16 Service.

17 So we would have probably sent it in a little
18 earlier if we hadn't been handicapped by that holiday.
19 But if that -- if that is the point in terms of those
20 number of days that moves us from a reasonable --
21 reasonable cause in -- in meeting the standard, to not
22 meeting the standard, I mean, that's a good discussion to
23 have. But I would probably argue -- I would present
24 that -- that this holiday just created that little bit of
25 a hiccup.

1 JUDGE AKIN: Understood. Thank you.

2 I don't have any additional questions for either
3 party.

4 JUDGE TAY: Thank you.

5 Judge Ewing, if you don't mind, I'm just going to
6 jump in one quick question for Franchise Tax Board because
7 it relates, and then I'll turn it over to you.

8 Franchise Tax Board, I just need a little bit of
9 clarity here. So we talked about the application of
10 Treasury Reg 1.338-10. And I think what you're saying is
11 that a taxpayer can have -- can apply for the penalty to
12 be waived under that Treasury Regulation. Additionally,
13 there is an abatement provision under 19132 that taxpayer
14 may also qualify for to receive abatement of the penalty.
15 Is that what your position is? Is that your
16 understanding?

17 MR. CRISTOBAL: Yes, Judge. That's correct. In
18 this scenario those two avenues would potentially be
19 available.

20 JUDGE TAY: Okay. So the taxpayer fails under
21 the waiver provision under the Treasury Reg. Then they
22 have the opportunity to argue reasonable cause under
23 19132?

24 MR. CRISTOBAL: Yes. While the avenues are
25 there, I would not make the comment on the -- or,

1 actually, my comment would be that it wouldn't -- it would
2 be a difficult argument to make, as I indicated too here.
3 Let's say you didn't make the waiver provision but then
4 try to make a reasonable cause argument afterwards, taking
5 Appellant's argument into consideration, I do want to make
6 that clarification that while the avenues are there,
7 acknowledging the avenues is not also a comment on the
8 success -- what the success rate would be making a
9 subsequent reasonable cause argument when failing to get a
10 payment waiver.

11 JUDGE TAY: Sorry. Would you clarify that just
12 so we understand? I know that it has -- I know Appellant
13 has not raised 338 arguments here during the hearing, but
14 they did not raise it in their brief. So would you mind
15 clarifying that, please?

16 MR. CRISTOBAL: Yeah. So under the 3 -- the
17 regulation for 338(g) election, when a penalty such as the
18 late-payment penalty applies, that penalty would be waived
19 if corrective action is taken by the same deadline as
20 the -- the same deadline to make the election. In this
21 case, corrective action would have been paying the tax and
22 the deadline to make the election, as has been discussed,
23 on June 15, 2017.

24 So if a waiver were to be obtained by Appellant,
25 they would have been needed to pay their tax no later than

1 June 15, 2017. That's sort of its own -- like I was
2 mentioning before, that's sort of its own avenue to
3 remedying the penalty that was assessed.

4 JUDGE TAY: Okay. I understand that, but what
5 you're saying is that it would be very difficult for
6 Appellant to obtain reasonable cause under 19132 if they
7 failed the waiver provision. But I don't see how
8 corrective action plays into consideration for reasonable
9 cause under 19132. Would you explain that?

10 MR. CRISTOBAL: The reason why I had said that is
11 because to show reasonable cause, as has been mentioned
12 before, you must show that you acted as an ordinarily
13 prudent businessperson and acted similarly under the
14 circumstances -- someone would have acted similarly under
15 the circumstances, an ordinarily intelligent and prudent
16 business person.

17 And so the argument from Respondent is that sort
18 of a professional matter, someone in a similar situation
19 as Appellant would have followed the remedy that is
20 provided under 338(g), and we're arguing that that was
21 something that was available for Appellant. They simply
22 failed to meet that to obtain that waiver. They filed
23 their election on June 5th and didn't pay their California
24 tax until a month later on July 5th. So that's that
25 portion.

1 And then so not to speculate on other
2 hypothetical situations that can occur, just talking about
3 what happened here, there hasn't been -- you know, other
4 than the arguments that has been presented, there hasn't
5 been an adequate showing of reasonable cause from
6 Appellant as to why they didn't pay their tax by the due
7 date, which was originally January 2017. And under 19132,
8 taxpayers have to show reasonable cause for not paying by
9 that due date.

10 JUDGE TAY: Okay. So I'm having a little bit of
11 difficulty seeing how reasonable cause under 19132 is
12 limited by the ability to fall underneath a safe harbor
13 provided by the law, and by making a payment before a
14 certain date that is after the original due date. Do you
15 have any case law or anything that would support your
16 position that failure to meet a safe harbor or some other
17 subsequent due date kind of negates reasonable cause?

18 MR. CRISTOBAL: Oh, sorry, Maria.

19 MS. BROSTERHOUS: Judge, would you mind if I
20 tried to answer a little bit of your earlier question?

21 JUDGE TAY: Please feel free.

22 MS. BROSTERHOUS: I think what Mr. Cristobal is
23 trying to say is that all things considered a reasonably
24 prudent taxpayer in acting as a reasonably prudent
25 taxpayer would attempt to meet the waiver provision in

1 order to -- that would be basically attempting to meet the
2 waiver provisions would be the actions of I reasonably
3 prudent taxpayer.

4 We're not saying that that precludes a finding of
5 reasonable cause separately under 19132. We're just
6 saying that the actions of reasonably prudent taxpayer
7 would such that they would attempt to meet the waiver.
8 But we are also saying that regardless of the 338(g)
9 waiver, Appellants have not demonstrated reasonable cause
10 such that the 19312 penalty should be abated in addition
11 to an -- okay. I'm sorry. Let me --

12 What I'm trying to say is that they still, in
13 spite of 338(g), has not established reasonable cause
14 here. So even without weighing that they -- that we
15 believe a reasonably prudent taxpayer would have attempted
16 to meet those waiver provisions, we don't see a
17 demonstration of reasonable cause.

18 JUDGE TAY: Okay. Thank you.

19 I'm going to turn it over to Judge Ewing, and I
20 apologize for jumping out of turn. But please,
21 Judge Ewing, do you have any questions for either party?

22 Judge Ewing, you're still muted. Sorry.

23 JUDGE EWING: There we go. Thank you, Judge Tay.

24 I do have one question related to something that
25 Mr. Connolly said in the main presentation and to see if

1 that was already explained when he discussed the issues
2 around the July 4th holiday.

3 Mr. Connolly, you mentioned a minor
4 administrative delay. I think I'm quoting you on what you
5 said. Is that what you were describing around the
6 July 4th holiday, or was that something different?

7 MR. CONNOLLY: Thank you, Your Honor. I'm sorry
8 about that. I did the same thing.

9 No. The July 4th holiday just merely exacerbated
10 that. As with any company -- as with any company, you
11 know, any process isn't going to be perfect every time,
12 and that we didn't have the check in hand before staff
13 went on holiday, our description of that delay is an
14 administrative -- what you call maybe an administrative
15 snafu. Again, we're talking about seven days in terms of
16 that when the return was filed to when -- prior to when
17 the holiday was started.

18 So within that process of finalizing a return,
19 filing the return, making the request for the check to be
20 issued, and then provided to us, and then so that we can
21 then put it into the UPS or United States Parcel Service,
22 yeah, I mean, we weren't perfect on that. We weren't
23 perfect on that.

24 But, again, if that's the issue, then -- because
25 we have not heard, we've just heard, "They don't have

1 reasonable cause," and we're not hearing why. We're
2 explaining the why. Here's the number of days. Here's
3 the process. And so if it's a number of days, we
4 understand there's room for disagreement. But we're not
5 even having that discussion.

6 So administrative delay was just -- you know, we
7 didn't get it completely right in terms of getting that
8 check processed -- requested, processed, and provided to
9 us timely. But, again, a number of days, then the holiday
10 did exacerbate that issue. It put us behind a little bit.
11 But, again, reasonable cause is asking us did we do
12 everything that we needed to do from a prudent's
13 perspective -- from a business care perspective, and we
14 still believe we are well within that.

15 I mean, we made the election within the time
16 required. We quickly filed -- prepared the federal return
17 and quickly filed that. Quickly filed -- prepared and
18 filed the California return and, again, a couple of days
19 delay with the payment of tax. The federal regulation
20 simply does not apply, and that's -- and we have not heard
21 why. And that was a great question. Why does -- why does
22 it apply when California has specifically said we're not
23 going to conform.

24 The fact that it shows up in a code section
25 regulation that California has conformed to does not -- is

1 not a backdoor to federal law applying to California law.

2 JUDGE EWING: Okay.

3 MR. CONNOLLY: And that's -- what's being
4 suggested.

5 JUDGE EWING: Thank you. I think you answered my
6 question that when you mentioned "a minor administrative
7 delay," earlier in your opening presentation, that was the
8 delay you were referring to. I just had a question if
9 there was something else we didn't hear about, but it
10 sounds like you're confirming that's what you were
11 referring to?

12 MR. CONNOLLY: Yeah.

13 JUDGE EWING: Okay. Okay. Thank you. That's
14 all I have, Judge Tay.

15 JUDGE TAY: Thank you, Judge Ewing.

16 I have a few questions for the parties. First
17 for Appellant, does federal case law apply with respect to
18 the late-payment penalty? So, for example, United States
19 versus Boyle, does that case apply to this appeal?

20 MR. CONNOLLY: Thank you for the question, Your
21 Honor.

22 I mean, as a broad statement, California chooses
23 when it's going to conform and follow federal law and
24 regulations authorized, they're under, and in doing so,
25 court cases explaining that federal law or regulation. So

1 it's a course of events. If California decides not to
2 conform to the penalty provision under the federal law,
3 then any Treasury Regulation providing relief to that
4 federal penalty provision does not apply and is not
5 relevant. And any case law describing and interpreting
6 those federal regulations and federal law simply don't
7 apply. There isn't room in California law for them to
8 apply.

9 JUDGE TAY: Okay. And with respect to United
10 States versus Boyle Supreme Court case, any thoughts on
11 its application specifically?

12 MR. CONNOLLY: I'll admit I've not prepared for
13 that question, and I'm happy to respond in a subsequent
14 filing, if that's -- if you'd like. But I think our
15 course of events, our pathway was not to have and rely on
16 federal law to explain California law for this particular
17 penalty provision.

18 JUDGE TAY: Fair enough. Thank you,
19 Mr. Connolly. I don't see the need necessarily for
20 additional briefing at this point on that case alone, but
21 I appreciate your response to that.

22 A couple of questions for Franchise Tax Board. I
23 think if you could respond to what I -- if you could
24 respond to whether or not, kind of, a good faith and, sort
25 of, effort to calculate tax due on a complicated situation

1 such an acquisition falls under ordinary business
2 prudence. Because I -- I realize that there are certain
3 business transactions that do take a lot of time to
4 understand the implications of and to really appreciate
5 all the complexities of. And so when a taxpayer is in
6 that kind of situation, like, would that fall under a
7 standard of ordinary business prudence.

8 MR. CRISTOBAL: Thank you, Judge. As it relates
9 to, you know, the facts of what happened in this case,
10 it's Franchise Tax Board's position that it does not fall
11 under that standard. You know as mentioned before and
12 previous case law has specifically said and it has been
13 established that complexity of the tax law is not
14 reasonable cause. I acknowledge the distinction you are
15 making with, you know, the complexity that can come with
16 corporate transaction -- or, you know, business
17 transactions.

18 Again, as it relates to the specific facts of
19 this case with the deadline to pay and the actual date
20 that Appellant paid their tax also juxtapose and
21 contrasted with the fact that they filed, you know, their
22 federal return and were able to pay the next day. We
23 believe that they haven't -- you know, based on all of
24 these things, they haven't risen to that standard of
25 showing reasonable cause.

1 JUDGE TAY: Okay. Thank you. And just to be
2 clear, the payment due date under -- after having made the
3 338(g) election that would have been December 15th; is
4 that correct?

5 MR. CRISTOBAL: The payment due date would have
6 been January -- oh, effectively, January 17, 2017.

7 JUDGE TAY: Okay. So after having made the
8 338(g) election it would have been January?

9 MR. CRISTOBAL: Well, the election to -- the 338
10 election doesn't change the due date. The due date was
11 January 17, 2017.

12 JUDGE TAY: I see. Okay. And so I guess we're
13 not really talking about seven days per se. Like, late is
14 late. Like, they were months late is what, I think, we
15 all agree on. Now, since we're talking about the facts of
16 this case, I'm going to ask Appellant to -- as briefly as
17 possible, I guess. Can you just provide some more details
18 about the process of making a 338(g) -- of deciding to
19 make a 338(g) election? And maybe, specifically, if you
20 could speak to whether or not that includes the estimation
21 of tax liabilities at the federal level and at the state
22 level, and maybe kind of a general timeline for how those
23 liabilities are estimated.

24 MR. TARBELL: Patrick, let me just speak for
25 60 seconds. You can fill in the blanks, but -- and you're

1 muted anyway.

2 So, yeah. Patrick and I have worked on a number
3 of these elections together, and there is a process. And
4 it is complicated, but we've done it enough to be familiar
5 with that process. So that entails working through the
6 balance sheet of the target corporation to determine what
7 kind of assets are there, performing evaluation of the
8 assets to do a purchase price allocation. And then from
9 there you have to allocate that amongst all the assets,
10 determine what your future depreciation or amortization
11 deductions are going to be, do a net present value calc to
12 get that back to today's dollars to determine if this will
13 make sense or not, layer into that tax attributes from the
14 target corporation if they have net operating losses,
15 credit carry forwards, et cetera.

16 And once you do all that for the federal, you
17 make the election and now you turn to your states and say,
18 okay, well, before we can do that calc, we need to make
19 federal to state adjustments. We need to determine which
20 states are going to conform and which ones will not. We
21 need to calculate apportionment factors for every state,
22 determination of this gain would be a portion to which
23 state and calculate the tax accordingly. So it just does
24 take time. And the fact, as Patrick pointed out, you
25 know, we filed the federal return June 13th. And

1 nine days later we had the California return done. That
2 has to be record timing for us.

3 So, Patrick, anything else you want to add?

4 MR. CONNOLLY: Yeah. No. I -- I don't, other
5 than just to emphasize that even the purchase price
6 allocation, which Stan is referring to, allows us then to
7 model whether or not the tax benefit of making a 338
8 election is -- is worth it. That purchase price
9 allocation is a process from time to time. We have to
10 hire others outside of the company to make that -- to do
11 that calculation, and it takes time. It takes time.
12 There's various assets in assigning how much we paid for
13 the stock of this particular company, Red Vision. How do
14 we allocate that cost to each of the assets of Red Vision
15 Systems?

16 And so that in and of itself takes time. Not
17 that in many cases that's not even in our purview in terms
18 of control, but there's a process. Again, Congress has
19 thought about this and said, you know, we think companies
20 need, you know, eight-and-a-half months to make a reason
21 decision. I mean, if they thought it only took a month,
22 three months, then Congress would have given three months
23 or a month. It's rare that Congress gives you more time,
24 right? So we believe that's an acknowledgment.

25 And from experience perspective we -- you know,

1 with that we're even rushed. We're even rushed to get to
2 that, you know, eight-and-a-half months, but we did. We
3 did do that, and it just -- it takes time.

4 JUDGE TAY: Thank you. I think I just have one
5 more question. And that's do the state tax considerations
6 ever drive the 338(g)-election decision? And maybe "ever"
7 is not fair. But in this situation, if and how did the
8 state tax liabilities or benefits drive that
9 338(g)-election decision.

10 MR. TARBELL: Yeah. Judge Tay, I'll take a crack
11 at that. I mean from our experience, I can imagine I
12 suppose when the state tax considerations would drive the
13 making of the election, but that's not very often. I
14 mean, the federal tax, especially back in 2016, was at
15 35 percent. And so that's typically going to outweigh
16 anything on the state's side.

17 MR. CONNOLLY: Yeah. And I would add to that.
18 In our particular case, I mean, we -- there was a net
19 operating loss carry over that was -- that tax attribute
20 was available. Now, we had to do our due diligence --
21 excuse me -- do our due diligence to get comfortable that
22 we could use that and rely on that NOL if we did not make
23 the 338 election. But, yeah. I mean, that's, you know,
24 how much tax are we going to pay upfront from a federal
25 perspective? Can we get that mitigated by the use of the

1 NOL because the 338 creates -- generally creates a gain?
2 And how reliable is that NOL?

3 You know, these are the things that from the
4 federal perspective, clearly because the rate is higher,
5 are going to be main considerations as Stan suggested.
6 But it doesn't mean how quickly we can calculate
7 California. I think that's the last, you know, part of
8 that -- that sentence.

9 JUDGE TAY: Just a clarification involved. So
10 what I'm understanding is you figured out the federal tax
11 consequences and then figured out state consequences, and
12 that depends on what state you're a part of, as well as
13 the conformity of those states and different
14 considerations such as that. So the first estimate of
15 California tax liability, you know, in this particular
16 case when you were making this decision about a 338(g)
17 election, when did you first estimate Red Vision's
18 California tax liability? I think you wrote that
19 information.

20 MR. TARBELL: Yes, Judge. I think that would
21 have been just prior to filing the return on June 22nd.
22 And as Patrick outlined, we did have administrative faux
23 pas there. But, yeah, about that time. So shortly after
24 the federal.

25 JUDGE TAY: Okay. And just -- sorry. One last

1 clarification question. You -- Red Vision filed and paid
2 their federal tax liability in the same day; is that
3 correct?

4 MR. TARBELL: I think so.

5 Right, Patrick.

6 MR. CONNOLLY: Yeah. We'll have to double check
7 on that.

8 JUDGE TAY: Okay. It might be in the records.

9 MR. CONNOLLY: And I don't know if we did the
10 electronic payment for California, or it was a check.

11 JUDGE TAY: Okay. Fair enough.

12 Okay. I have no further questions. I'm just
13 going to look to my panelist one more time.

14 Judge Akin or Judge Ewing, any questions?

15 JUDGE AKIN: Judge Akin speaking. No additional
16 questions.

17 JUDGE TAY: Judge Ewing, you we're muted. But
18 I'm assuming that you have no further questions.

19 JUDGE EWING: No further questions. Thank you.

20 JUDGE TAY: Okay. All right. My apologies for
21 holding people longer than we estimated. However, I
22 thought that was a fruitful hearing. Thank you everyone
23 for your presentations today. The record in this appeal
24 is now closed, and the appeal will be submitted for
25 just -- for decision. We will endeavor to issue our

1 written decision no later than 100 days from today.

2 The hearing is now adjourned.

3 Again, I'd like thank the parties once again for
4 appearing and making their presentations today.

5 (Proceedings adjourned at 12:07 p.m.)

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