

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)	
)	
KRITON CORPORATION,)	OTA NO. 20046093
)	
J. VAKILIAN and F. VAKILIAN,)	21037402
)	
APPELLANT.)	
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TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Friday, March 24, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 9:35 a.m. and concluding at 11:10 a.m. on
Friday, March 24, 2023, reported by Ernalyn M.
Alonzo, Hearing Reporter, in and for the
State of California.

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APPEARANCES:

Panel Lead: ALJ OVSEP AKOPCHIKYAN

Panel Members: ALJ ANDREA LONG
ALJ TOMMY LEUNG

For the Appellant: F. VAKILIAN
KEVIN WALDRON
MICHAEL DALLO

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

D'ARCY DEWEY
JASON RILEY
BRADLEY KRAGEL

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-25 were received at page 8.)
(Department's Exhibits A-RR were received at page 7.)

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California; Friday, March 24, 2023

9:35 a.m.

JUDGE AKOPCHIKYAN: We are going on the record in the consolidated Appeals of Kriton Corporation, J. Vakilian and F Vakilian. The OTA Case Numbers are 20046093 and 21037402.

I'm hearing background noises.

Today is Friday March 24, 2023, and the time is approximately 9:30 a.m. We are holding this appeal electronically via Webex by the consent of all parties. This appeal is being heard by a panel of three Administrative Law Judge. My name is Ovsep Akopchikyan, and I'm the lead judge for purposes of conducting this hearing. Judges Andrea Long and Tommy Leung are the other members of this panel. All three judges are equal decision makers and may ask questions to make sure we have all the information we need to decide this appeal.

Now for introductions, will the parties please identify yourselves by stating your name for the record, beginning with Appellants.

MR. WALDRON: My name is Kevin Waldron attorney for the Appellant.

JUDGE AKOPCHIKYAN: For the Franchise Tax Board?

MS. DEWEY: Good morning. My name is D'Arcy

1 Dewey representing Franchise Tax Board. I'm here with my
2 colleagues. I will let them introduce themselves.

3 MR. RILEY: Jason Riley representing Franchise
4 Tax Board.

5 MR. KRAGEL: Ben Kragel representing the
6 Franchise Tax Board.

7 JUDGE AKOPCHIKYAN: Thank you all.

8 As discussed, and agreed upon by the parties at
9 the prehearing conference on March 2nd, 2023, and as noted
10 in my prehearing conference minutes and orders, there are
11 two issues remaining on appeal: First, whether FTB erred
12 in disallowing Kriton Corporation's deduction for officer
13 compensation paid to the Vakilians in the amount of
14 \$200,000 for the 2012 tax year and \$370,000 for the 2013
15 tax year; second, whether Appellants have established a
16 basis to abate the accuracy-related penalty.

17 With respect to the evidentiary record in the
18 Appeal of Kriton Corporation, FTB submitted Exhibits A
19 through R with its opening brief and Exhibit AA through CC
20 with its reply brief. In the Appeal of Vakilian, FTB
21 submitted Exhibits A through Q with its opening brief.
22 During the prehearing conference, OTA relabeled FTB's
23 exhibits submitted in Appeal of Kriton Corporation as
24 Exhibit A through U and the exhibits submitted in the
25 Appeal of Vakilian as exhibits B through LL. Appellants

1 did not object to the admissibility of these exhibits.

2 After the prehearing conference, FTB submitted
3 additional exhibits. Exhibits MM through RR. Exhibit MM
4 through PP are four precedential decisions decided by the
5 Office of Tax Appeals. Exhibit QQ is a redacted copy of
6 Kriton Corporation's bank statement from June 2013 through
7 August 2013. Lastly, Exhibit RR is a redacted copy of the
8 Vakilians' federal account transcript for the 2013 tax
9 year.

10 Do Appellants have any objection to the
11 admissibility of the new exhibits?

12 MR. WALDRON: No.

13 JUDGE AKOPCHIKYAN: All of FTB's exhibits, that
14 is Exhibits A through RR are entered into the record.

15 (Department's Exhibits A-RR were received in
16 evidence by the Administrative Law Judge.)

17 Turning to the Appellants' exhibits. In the
18 Appeal of Kriton Corporation, Appellant submitted Exhibit
19 A through F with their opening brief, Exhibit 1 with their
20 reply brief, dated June 15th, 2021, and Exhibit A through
21 G with the reply brief, dated December 29, 2021.

22 In the Appeal of Vakilian, Appellants submitted
23 Exhibits A through E with their opening brief and
24 Exhibits A through F with their reply brief. During the
25 prehearing conference, OTA relabeled Appellants' exhibits

1 submitted in the Appeal of Kriton Corporation Exhibits 1
2 through 14 and the exhibits submitted in the Appeal of
3 Vakilian as Exhibit 15 through 25. FTB did not object to
4 the admissibility of these exhibits. Therefore, all of
5 Appellants' exhibits, that is Exhibits 1 through 25 are
6 entered into the record.

7 (Appellant's Exhibits 1-25 were received
8 in evidence by the Administrative Law Judge.)

9 Lastly, as discussed at the prehearing
10 conference, Appellant S. Vakilian and Steven Starkey, a
11 tax preparer, will be testifying as witnesses today.

12 As agreed, the hearing will begin with
13 Appellants' presentation, including both testimonies for a
14 total of 70 minutes. FTB will then have 40 minutes for
15 cross-examination of the witnesses and its presentation.
16 Appellants will have 5 minutes for rebuttal.

17 Does anyone have any questions before I swear in
18 Mrs. Vakilian and Mr. Starkey for their testimony?
19 Hearing none, thank you.

20 Ms. Vakilian, please raise your right hand.

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

1 JUDGE AKOPCHIKYAN: Mr. Starkey, please raise
2 your right hand.

3
4 S. STARKEY,
5 produced as a witness, and having been first duly sworn by
6 the Administrative Law Judge, was examined and testified
7 as follows:

8
9 JUDGE AKOPCHIKYAN: Thank you.

10 Mr. Waldron, please proceed with your
11 presentation when you are ready.

12 MR. WALDRON: Thank you.

13
14 PRESENTATION

15 MR. WALDRON: Good morning everyone. Like I said,
16 my name is Kevin Waldron. I'm the attorney for the
17 Appellants. As we talked about, there are two main issues
18 on appeal. The first is reasonable compensation for the
19 years of 2012 and 2013. The second covers was there
20 reasonable cause to abate the accuracy-related penalty. I
21 don't know if -- hopefully, you guys got my power point
22 presentation so you can hopefully follow along a little
23 bit and kind of see my main point.

24 But -- so first off, yeah. As far as reasonable
25 cause goes, there are two secondary arguments. First is

1 that they relied on a professional and the advice of a
2 professional which qualifies for reasonable cause
3 abatement. And secondly, they exercised ordinary care and
4 prudence in spite of the underpayment. And that's also
5 sufficient to remove the accuracy-related penalty.

6 So turning to that first issue under
7 compensation. The Appellants' arguments are largely going
8 to be just contained in the brief. We are largely
9 submitting just two arguments and authority listed there.
10 Today Frieda is going to testify and talk about just what
11 she was doing, and what they were doing at the end of 2012
12 and 2013 when the business was being sold and why it was
13 necessary and therefore, why the compensation that they
14 received was necessary. But largely for reasonable
15 compensation it's going to be contained in the briefs. So
16 today I'm going to be mainly talking about reasonable
17 cause.

18 So moving on to reasonable cause, the whole main
19 tax stems from a liquidating distribution of Kriton
20 Corporation, which was a C corporation, and this was in
21 2013. And that's what generated the main portion of the
22 tax that resulted in this appeal. So the first argument
23 that Appellants have asserted is that they relied on the
24 advice of professional, and that qualifies as reasonable
25 cause to abate the accuracy-related penalty.

1 When courts look at reliance on a professional,
2 there's a three-factor test, and I think both parties have
3 agreed on the three factors largely. And the first factor
4 is did the taxpayer rely on a competent professional. The
5 second factor is did the taxpayer provide necessary
6 information to prepare the accurate return. And third,
7 did the taxpayer rely on a professional's advice in good
8 faith.

9 So turning to our first factor, we have was a
10 professional competent. And when courts look at the legal
11 standard for this, when they examine a professional's
12 competency, they look at their credentials and the
13 experience of the adviser and context of the advice that
14 was given. And enrolled agents and CPAs are continuously
15 found competent. It's a matter of regularity. You'll
16 see, and I'll touch on these issues later. But CPAs and
17 E.A.s their general purpose is related to tax and courts
18 find them competent a lot of the time.

19 The facts of this case are the Vakilians'
20 preparer was Steven Starkey. And they were referred to
21 Steve by a previous preparer who said that Steve had more
22 experience and could better help them with the sale and
23 the liquidation. Steve has been an IRS enrolled agent
24 since 1988 and has prepared thousands of corporate and
25 personal returns. The IRS' website lists what is required

1 to be an enrolled agent.

2 And according to the IRS, enrolled agents have to
3 pass a three-part comprehensive test covering individuals,
4 business returns, and ethics. They have to adhere to
5 ethical standards, and they have to complete 72 hours of
6 continuing education courses every three years. And it's
7 even more than attorneys, actually. Attorneys do 25. And
8 the IRS describes enrolled agents, per their website, as
9 an elite status and is the highest credential that the IRS
10 awards. And enrolled agents are unrestrictive on what tax
11 matters they can handle.

12 So moving on. We're applying the facts and the
13 legal standards of this case. Appellants assert that it's
14 clear that Steve was a competent professional to advise
15 the Vakilians of liability on the personal and corporate
16 returns. FTB's main arguments in their brief generally
17 are that the -- Steve's application of liquidating
18 distribution rules was evidence that he was a competent
19 professional. However, this misses the legal standard,
20 and it misses the point.

21 The court's focus on credentials and experience
22 of the advisor. They do not look at did they make a big
23 mistake. Was the mistake a simple issue, and a better
24 adviser could have done it. They simply look at
25 competency as credentials and experience. And when a

1 court finds a professional to be incompetent, it's because
2 they have credentials that are unrelated to the advise
3 being given or unrelated to tax.

4 So, for example, in Brashear it was a stockbroker
5 who gave advice on a retirement distribution. Or in
6 Farias it was a medical professional that gave advice on
7 un-reimbursed employee expenses. The Court said these
8 people have no credentials or experience related to tax.
9 There's no competent advice. And as I mentioned earlier
10 and the cases said E.A.s and CPAs are continuously found
11 competent. And they are found competent even when they
12 give advice that's wrong for simple issue, and this is not
13 a simple issue.

14 We have a C corporation distributing in a
15 liquidating distribution. And it was on an installment
16 sale basis from 2012 and 2013. And as these cases show,
17 CPAs and E.A.s can be competent on a wide variety of
18 issues. And in all those cases the professionals are
19 found competent even though they had given erroneous
20 advice.

21 Moving on to the second factor, it's a little
22 brief. I don't think the parties really dispute it.
23 There wasn't really any dispute during the briefing stage.
24 So just briefly the legal standard is just courts look at
25 whether the taxpayer provided the professionals with all

1 the materials necessary to prepare the return. And in
2 this case the Vakilians provided everything necessary to
3 calculate a gain on liquidating distributions.

4 So I don't think there's much disagreement among
5 the parties, but everything that was necessary was given.
6 They -- Steve had the amount of the distribution. He had
7 whatever basis was claimed for the balance sheet and the
8 returns. So there was all information necessary to report
9 a liquidating distribution and capital gain on the
10 personal return.

11 And then finally moving on to the third factor
12 for reliance on a professional. The -- whether the
13 taxpayer relied in good faith on the advice of the
14 preparer. And the Supreme Court in Boyle focused on the
15 standard. And they said that when an attorney or
16 accountant advises a taxpayer on a substantive matter of
17 tax law, such as whether a tax liability exists, it's
18 reasonable for the taxpayer to rely on that advice. The
19 Court's reason that taxpayers are not competent -- most
20 taxpayers are not competent to discern the error on the
21 advice of the accountant or the attorney.

22 And if they had -- if the taxpayer was required
23 to go challenge a professional and seek a second opinion,
24 the Court found that it would just swallow the rule and
25 there would be no purpose of actually consulting a

1 professional or an attorney or a tax professional if they
2 had to constantly challenge them, double check them, seek
3 a second opinion on all of their advice. The Court said
4 that's not the standard.

5 And the facts of this case are that Steve gave
6 the Vakilians explicit advice that they did not have
7 personal liability from the sale of Kriton and the
8 liquidating distribution. They only had corporate
9 liability, which the Vakilians paid. And when the
10 Vakilians reviewed their personal tax returns, there was
11 no capital gain listed from the sale and liquidation of
12 Kriton.

13 So applying those facts to the analysis that the
14 Supreme Court elucidated in Boyle, the Appellants'
15 argument is clear that Steve advised the Vakilians on
16 whether there was personal and corporate liabilities
17 resulting from the sale and liquidation of Kriton, and the
18 Vakilians are entitled to rely on that advice. They're
19 not required to double check it, ask him how he came up
20 with it. They are just entitled to rely on his advice, so
21 they didn't have any personal liability.

22 And California's arguments in their briefing
23 generally boil down to two main points. First, they
24 assert that the Vakilians did not actually receive advice
25 from Steve, and this is incorrect for two reasons. First,

1 that they received explicit advice from Steve. They
2 verbally informed they do not have a personal liability
3 from this liquidation, and that is explicit advice.

4 And secondly, they received implicit advice when
5 there was no capital gain from the liquidation on the
6 personal return. And advice can be implicit as several
7 cases I have found. In the Kroll case, the court found
8 that advice was implicit when the preparer had everything
9 necessary to report a foreign inheritance. And the
10 adviser did not prepare the form to report the foreign
11 inheritance. The court found that because an adviser had
12 everything to generate it and it was on notice that it was
13 needed and -- but did not prepare it, he had therefore
14 advised the taxpayers implicitly that form was not needed.

15 Same here. No capital gain on the personal
16 return from the distribution, therefore, implicit advise
17 that there was no gain from the distribution. And FTB's
18 second point mainly is that they did not reply on Steve's
19 advice in good faith because a tax-free distribution is
20 not reasonable, and they should have looked into it more.
21 However, tax redistributions actually happen with some
22 regularity throughout the code.

23 They can happen through qualified small business
24 stock where the sale -- the gain on the sale of stock for
25 a C corporation can be fully excluded, and California

1 conformed to that back in -- I think it ended in 2012, but
2 California conformed to it for a while. They have --
3 stock dividends are a way for tax redistribution and
4 the -- that's only, you know, tax on the sale later. And
5 basis. Basis can always prevent tax on a distribution.

6 So and then -- but even if they could recognize
7 that, the Supreme Court in Boyle said they are not
8 required to. They are not required or equipped to discern
9 any error in Steve's advice. And especially when we have
10 complex tax issue with a C corporation liquidating on an
11 installment sales basis over several years. And
12 California cited some authority to show that the Vakilians
13 did not act in good faith. However, those cases deal with
14 distinguishable facts.

15 The advisers in those cases, like in Kerman, for
16 example, they dealt with a promotional tax scheme that the
17 adviser was promoting, and the Court found that's not good
18 faith reliance. Or in Walton the taxpayer didn't review
19 their return and didn't see an omitted 1099 payment. The
20 Court said clerical error. No -- yeah. It's not in good
21 faith. Those cases are not the case here. We have a
22 transaction that requires calculation and analysis. It
23 requires advice, and the Vakilians are entitled to rely on
24 that advice.

25 And just like the Supreme Court said in Boyle, to

1 monitor the counsel, to monitor the provision of the code,
2 and to monitor the adviser, it would swallow the rule. It
3 would not make sense to even seek advice of an expert. So
4 concluding on that point, the Vakilians relied on Steve's
5 advice on whether that personal liability resulting from
6 the sale and liquidation of Kriton. They were entitled to
7 his advice, and they did so in good faith.

8 And finally moving on to the final point for
9 reasonable cause to abate the accuracy-related penalty.
10 The tax -- even if they, you know, assuming or they didn't
11 rely on a professional, they still acted with ordinary
12 care and prudence despite the underpayment such that the
13 penalty should be removed. When courts look at whether a
14 taxpayer exercised ordinary care, they look at the
15 taxpayer's education, experience, the complexity of the
16 tax issue, and what the taxpayer did in the face of that.

17 And in our case, we have Josef and Frieda
18 Vakilian. They are the sole owners of Kriton. The
19 business was a gas station, and this is their first
20 entity. They've never had a C corporation before. They
21 ran a computer repair sole proprietorship out of their
22 home once for -- you know, Frieda will testify a little
23 bit more about that. But they have no corporate
24 experience, no tax experience, no tax education.

25 They sold the C corporation in 2012 through an

1 installment sale, and the final installment was paid in
2 2013, and all the cash was distributed in 2013 in a
3 liquidating distribution. And applying those facts to the
4 legal standard, the -- when we take into account the
5 taxpayers' education the -- and experience, the Vakilians
6 were not sophisticated taxpayers. They had never sold a
7 business. They've never had a corporate entity. They
8 have bachelors, Frieda in social work, Joe in
9 telecommunications. They don't have tax education or
10 experience.

11 The -- and in the face of that, the issue that
12 they dealt with that generated all this tax was complex.
13 They acted, even though -- even though they had a complex
14 tax transaction, they still recognized that it was
15 complex, and they sought out the advice of another expert
16 who they were referred to. And they said we cannot
17 properly assess what our liability is. We need help. All
18 that they did was find another expert, try to get advice
19 for it. And from their perspective, they had done a lot.
20 They invested a lot of money into this business.

21 Over the years there was losses, several years.
22 It barely turned a profit at times. They already paid tax
23 on the sale at the corporate level. And now when their
24 adviser is telling them they don't have to pay any more
25 personal tax, there's not much a taxpayer can do. And so

1 for that reason they exercised ordinary care despite this
2 underpayment.

3 And that's our main -- those are our main points.
4 So I'd like to turn to Frieda and just get some of her
5 testimony.

6 Actually, you know, Steve, can we start with you?

7 MR. STARKEY: Sure.

8

9 DIRECT EXAMINATION

10 BY MR. WALDRON:

11 Q Great. I was -- I'd like you to, if you don't
12 mind just talking about your tax preparation background
13 and experience?

14 A This is Steve Starkey. I became licensed to
15 prepare taxes back in 1980. I have a sole proprietorship
16 company that employs three other enrolled agents and
17 another tax preparer. I have a tax attorney on staff. We
18 do bookkeeping. We do payroll, and we also have an
19 insurance license and a security license. And I say we,
20 my son and I, have security licenses. So we offer a
21 full-fledge financial portfolio here.

22 In 1988, I became licensed as an enrolled agent,
23 and every year since then I have far exceeded the
24 continuing education requirement. And over the years I
25 have built up a practice that started with absolutely

1 nothing to as many as 3,100 clients. I have experienced
2 businesses, S corporations, C corporations, LLCs,
3 non-profits, as well as just sole proprietors in business.
4 I have done audits with the State Board of Equalization,
5 the Franchise Tax Board, IRS, very familiar with the
6 procedure. I have done some appeals and even have done
7 some legal work through the tax attorney that's in my
8 staff.

9 I met the Vakilians in late 2012. They had been
10 referred to me from a gentleman that I had met previous
11 and was -- he almost considered coming to work for my
12 firm. And he referred them to me based upon my experience
13 and the ability to do research and to seek out ways that
14 might be able to help them.

15 Q Okay. And -- okay. So yes. That answers my
16 other question of how you came to engage with the
17 Vakilians. And so turning to the final distribution, can
18 you talk about what conclusions you communicated to the
19 Vakilians, if any, about the liquidating distribution?

20 A Absolutely. So when I met the Vakilians they had
21 done an installment sale on the sale of this gas station
22 convenience store, and it was a twofold problem. They
23 were, one, concerned that perhaps this gentleman wouldn't
24 make all the installment payments. And the other thing
25 was that the corporation was still active in my opinion.

1 They were getting checks that were payable to
2 Kriton Corporation. So they still had their bank account
3 open. They were still commuting from their home in San
4 Diego County up to the place where their business was to
5 help out with the sale and to answer questions and just to
6 help guide them along.

7 So when I looked at the situation here, I
8 analyzed it, which I've done on many other occasions. But
9 in this case, it was a little bit different because it was
10 an installment sale and there was concern that they may
11 not get paid in full, that this guy may walk away from it,
12 that he may get discouraged.

13 So I looked at it and looked at it and looked at
14 it, and I'm familiar with QSBS, qualified stock business
15 sale, and so I'm familiar with that. I also looked at the
16 tax returns and I saw the depreciation schedule. So I
17 kind of had an idea basis, and I could see that this was
18 going to result in a large amount of tax. So I looked at
19 different ways that I could look at this so that I could
20 save them the most amount of money, and my conclusion was
21 that I was going to keep the corporation open.

22 I was going to keep the corporation open. I was
23 going to put both Mr. and Mrs. Vakilian on payroll so that
24 they can draw salaries from it since they were getting
25 this money payable to Kriton Corporation. They already

1 had payroll accounts opened up with the IRS and the
2 Franchise Tax Board. So I gave the advice to
3 Mr. And Mrs. Vakilian to go on salary, which they did pay
4 themselves.

5 They paid the payroll taxes from them. I knew
6 because they were commuting up there and working and
7 gainfully being -- and not gainfully being employed, but
8 they were certainly providing a service there. So I knew
9 they met the requirement for being able to -- to draw a
10 paycheck on it. And since the money was being paid in
11 Kriton, I just went ahead and did payroll through the
12 Kriton Corporation with salaries to both Mr. and
13 Mrs. Vakilian. And I also wrote off the milage going up
14 to do the work up there. So in that respect I thought
15 they met all the criteria there.

16 So in 2012 when I did the return, we had claimed
17 all the income that was paid in there, and the Vakilians
18 paid about a quarter-of-a-million dollars in tax on the
19 corporate level. And, of course, because they paid it on
20 the corporate level, they still had the stock. The stock
21 hadn't been liquidated. There hadn't been anything done
22 with that. I didn't consider anything on the personal
23 side.

24 So we just paid tax based upon their W2s that
25 they had, which were very large W2s based upon the monies

1 that they were getting to Kriton Corporation from the
2 payments that were being made to them. And then, of
3 course, there are other things that were involved on their
4 personal taxes that didn't have anything to do with
5 Kriton.

6 In 2013, it came to my attention that they were
7 going to get paid off in full on their -- on the sale.
8 And so I again put them on payroll, did the payroll
9 reports, took these large salaries, paid the payroll taxes
10 on them -- the Vakilians did. And because all that money
11 was taxed at the corporate level, they still had the
12 stock. I didn't think the company had any basis in the --
13 there wasn't any stock to sell. They didn't have it. It
14 had already been paid through the corporation.

15 So therefore, when it came to the personal
16 return, I prepared the personal return based upon W2s and
17 the other items that the Vakilians had on their return.
18 There was nothing considered on the stock because the
19 stock technically still wasn't sold. It was zero basis
20 and zero cost on it. And so I told them that all they had
21 to do in 2013 was pay almost a half-million dollars in
22 corporate tax. They didn't owe any tax based on the
23 personal return.

24 I had explained that to them. It was my argument
25 when we got audited, and I met with Mr. Garcia on the

1 audit. It came to my attention that I may have overlooked
2 something, and so I presented my case with him. I didn't
3 seem to get anywhere with him, and that's when I sought
4 out, on my own -- I told the Vakilians what was going on.
5 I told them I am going to go seek other legal counsel and
6 see what I can find out to help you.

7 I interviewed many other attorneys from Orange
8 County and San Diego County which was a nightmare. But
9 anyway, I eventually ended up with Mr. Dallo and his
10 staff, and this is kind of where we're at today.

11 Q Okay. Thank you. And then -- and then okay.
12 Thanks.

13 MR. WALDRON: And then I'm going to turn to
14 Frieda to talk about a couple of things.

15
16 DIRECT EXAMINATION

17 BY MR. WALDRON:

18 Q First, I was kind of -- to touch on the
19 reasonable -- the compensation issue. I was hoping you
20 can talk to everyone. Describe what you were doing in
21 2012 and 2013 and why you and Joe were still working for
22 Kriton?

23 A Okay. Well, needless to say, we were very happy
24 that we finally sold the gas station. That happened in
25 February -- February 2012, actually. However, the new

1 owners had no gas station experience at all, and we were
2 very worried from the very beginning that it may backfire.
3 We may have to take it over again. Also, a tragedy
4 happened to them because one of the owners, a brother who
5 was supposed to be doing all the mechanical work and we
6 helped to train, he died within two months of liver
7 cancer.

8 So they were very, very shocked, and we were
9 thinking they may not want to take over the business at
10 all. This all happened right after they had taken over
11 the business. And we were still out there in Harbor City
12 where we had our business, and we spent practically every
13 day at the gas station first, trying to orient them
14 because they had no experience. They came from owning a
15 doughnut shop, really, and then this death in the family.

16 So my husband was there every day, basically.
17 And I had gone back to Vista where we live, but also drove
18 up there all the time. And it seemed that we basically
19 spent full time there partially, and then part-time. And
20 we -- you know, they were dealing with grief and then the
21 new business that they were not familiar with. So it was
22 a very difficult time. And like I said, we always
23 thought, oh, we have to take over the business again, and
24 they will, you know, just back out of it altogether,

25 Well, fast forward then. Well, we got paid on

1 like we -- like Steve already said, on an installment sale
2 and received monthly checks. And we were not expecting to
3 get fully paid for years to come. But in 2013 somehow
4 they did refinance, and we were paid in full. That
5 happened -- yeah, I guess it was midyear 2013. And we
6 expected to close the corporation, of course, then since,
7 you know, we no longer existed as Kriton Corporation.

8 We no longer got any payments, and that was the
9 situation. Then we also saw Steve at that time and wanted
10 him to close the corporation and get the advice that was
11 needed to do everything correctly.

12 Q Before we go into that, can you describe a little
13 more about what you needed -- what they needed help with
14 and what you guys would help with each day, roughly?

15 A Yeah. Well, they needed help with everything,
16 you know. They needed help in running the gas station.
17 It was a very difficult process. The software was very
18 complicated. We had -- I mean, ARCO had recently graded
19 their software. Italic Software was incompatible with the
20 computers. There were lots of problems, and we were
21 already seasoned with all the problems that might occur.

22 You know, just imagine you have 16 pumps, and
23 they all shut down at the same time. So, you know,
24 customers who paid outside and then could not get gas, it
25 was really havoc sometimes. One time I had to call 911

1 because one customer, you know, one customer just became
2 violent and knocked out another customer who said just be
3 patient. This was the kind of environment we were dealing
4 with. It was very stressful.

5 So yes, we were there every day, and they needed
6 help. I know I trained them in all the office procedures.
7 I did most of the office work, and my husband was doing
8 everything else that was needed. There was so much going
9 on every single day. There was never a peaceful day,
10 really. And they were dealing with all the grief losing
11 their family member. So it was, you know, on-site. You
12 had to be there to really train them, you know, on the
13 pumps, on the mechanical issues, and calling customer
14 support.

15 There were a lot of technical issues and, you
16 know, my husband was very, you know, very experienced in
17 that, you know. He -- he was a fast learner with all the
18 mechanical issues, you know. Whereas, I, you know, I took
19 care of the office environment. And that was a lot
20 keeping all the licenses current and all the inspections
21 that had to happen. And it was very stressful.

22 So we really needed to be there, and we were very
23 worried like I said that it might not work out and we have
24 to take over. That's why we still had our house in
25 Torrance, and we were driving back and forth. And my

1 husband was staying there with mostly all the driving back
2 and forth but being there almost full time. We're talking
3 about months, really.

4 Q Okay.

5 A Yeah.

6 Q And can you just briefly touch upon your
7 educational level?

8 A Well, now I'm a 71-year-old grandmother of four.
9 But back then my husband and I met in Munich. I was born
10 and raised in Bavaria, and I immigrated in 1976. I'm
11 actually an R.N. with a bachelor in social work. I
12 studied in Munich and Berlin and then came here to San
13 Diego State and got my bachelor in social work here at San
14 Diego State. So my field was always nursing. I worked as
15 an R.N. in mental health with the County of Mental Health
16 at Tri-City Medical Center.

17 But then we -- we decided to go into a
18 business -- a family business, and I worked part-time and
19 work in the family business that we started from our
20 garage, initially. So it was a small proprietorship, but
21 that --

22 Q What did you guys do in that?

23 A We did computer repair.

24 Q Okay.

25 A Yeah, computer repair. And that we ended that in

1 2003 and then decided to purchase an ARCO gas station.

2 Q And so then how did you -- and then I think Steve
3 touched on this, but how did you get in touch with Steve?

4 A Okay. Steve was highly recommended from our
5 previous tax preparer, Mr. Stevens. And that's how we met
6 Steve. And, you know, we were -- we wanted somebody who
7 can close the corporation because that was our intent.
8 Kriton was to end, and it needed to be done. And so
9 that's how we met Steve. He was really highly
10 recommended. We met him. We felt very comfortable, you
11 know. And he laid it out what needed to be done, and we
12 felt very comfortable in dealing with him.

13 Q And in 2013, so you -- when you liquidated
14 Kriton, do you remember did Steve communicate anything
15 about that liquidation, specifically referencing your
16 personal return?

17 A Well, you know, we trusted him. Like I said, he
18 laid it out to him, and we had paid -- we felt we had paid
19 so many taxes for everything that was, you know, said at
20 that time and was, you know, was accurate, you know. So
21 he, you know, he told us we have no personal liabilities.

22 We always believed that because, you know, we
23 paid so many taxes so it must be all, you know, in
24 accordance with what needs to be done, you know. And that
25 was our intent to get everything behind us and, you know,

1 move on.

2 Q Okay. And do you remember ever reviewing the
3 return?

4 A Yes. You know, we -- you know, I got to review
5 the returns, you know.

6 Q Okay.

7 A Yes. He in his office, you know, we definitely
8 did that.

9 Q Got it.

10 A Yeah.

11 MR. WALDRON: Okay. And I think, unless there's
12 anything else you want to say, I think we -- Appellants'
13 case is rested.

14 JUDGE AKOPCHIKYAN: Thank you, Mr. Waldron. I'm
15 going to turn it over the Franchise Tax Board to see if
16 they have any questions for either witness.

17 MS. DEWEY: We do. So I guess let's start with
18 Mrs. Vakilian.

19

20 CROSS-EXAMINATION

21 BY MR. RILEY:

22 Q Can you hear me, okay?

23 A Yes, I can.

24 Q Again, this is Jason Riley with the Franchise Tax
25 Board. Okay. Ms. Vakilian, you were the chief financial

1 officer of Kriton; correct?

2 A Yes.

3 Q Did Mr. Starkey prepare your 2013 personal tax
4 return?

5 A Yes, he did.

6 Q Did you inform Mr. Starkey that you and your
7 husband were the shareholders of Kriton Corporation or the
8 sole shareholders?

9 A He was aware of that, yes.

10 Q Okay. And you stated that you sold it on an
11 installment sale where you received regular payments until
12 money was completely paid; is that correct?

13 A Yes.

14 Q As CFO did you handle the deposits for Kriton?

15 A What's deposits? Do you mean the --

16 Q The bank deposits?

17 A Oh, yeah. The bank deposits, yes, I did.

18 Q Okay. Thank you. Did you receive payment from
19 the purchasers in each month during 2013 for the gas
20 station?

21 A Yes. While they were making payments, yes. We
22 received a personal check. We received a check for, you
23 know, made out to Kriton Corporation. Yes.

24 Q Okay. Thank you. I apologize for talking over
25 you. Did you receive the final lump sum for the sale of

1 the service station in two wire transfers for about
2 \$3.3 million on June 4th, 2013?

3 A I don't recall the exact date, but that seems to
4 be correct.

5 Q Okay. And this was the, like the final big
6 payoff of the installment sale, the \$3.3 million?

7 A Yes.

8 Q Would you consider this payoff of \$3.3 million to
9 be a major amount for you and your husband?

10 A Oh, yes. Yes.

11 Q Did you personally withdraw \$1 million from the
12 corporation between June 5th and June 7th of 2013? It
13 looks like through wire transfers.

14 A I'm not sure. I mean we invested some money then
15 in Merrill Lynch. It could be that it's this amount. I'm
16 not certain now.

17 Q Okay.

18 A Yes.

19 Q Did you file a personal amended federal return to
20 report additional tax from a liquidating distribution of
21 Kriton Corporation for the 2013 taxable year?

22 A I do not believe so.

23 Q Okay. At appeal your representatives provided
24 for you additional documentation to substantiate more than
25 \$1 million of basis in Kriton Corporation. Had you

1 provided Mr. Starkey with each of these documents prior to
2 the filing date of your 2013 personal tax return? And
3 that date was February 10th, 2014?

4 A Yes. I provided him with all the documents that
5 we had. All the paperwork I always brought it to him,
6 yes.

7 Q Okay. Did you provide -- okay. Let's move on.

8 So you provided that to Mr. Starkey. Did
9 Mr. Starkey include your basis in Kriton Corporation on
10 your 2013 personal tax return?

11 A Yeah. I'm not certain exactly, you know.

12 Q Okay.

13 A I just -- you know, I mean I'm not sure.

14 Q Did you review your 2013 personal tax return?

15 A Yes, I did review. But, you know, I have to
16 say -- I mean, if you ask me about all the numbers, I
17 probably could have overlooked something. I was just
18 always glad -- always done fine, but I did review it. I
19 did get to see it. Yes.

20 Q Okay. In that review did you make sure that all
21 of your income from the liquidating distribution of Kriton
22 Corporation was included?

23 A Yes.

24 Q Did you make sure that all major income items had
25 been included?

1 A I always believed, yes, it was there.

2 Q Okay. Did you notice that the sale of Kriton
3 Corporation was not reflected in your 2013 personal return
4 as prepared by Mr. Starkey?

5 A I thought it did not have to be there because it
6 was personal.

7 Q Did you notice that your 2013 return made no
8 mention of the liquidating distribution or the -- any
9 offsetting basis in Kriton?

10 A Well, I always thought this is the corporate
11 return, and the personal is totally different. And so
12 I -- I'm -- I'm really not sure.

13 Q Did you ever ask Mr. Starkey why the gain on the
14 sale of the service station was not reflected on your
15 return -- on your personal return?

16 A I don't think I asked him. No.

17 Q Okay. Is it reasonable to assume that a personal
18 gain of more than \$2 million would be tax free?

19 A Well, like I said, I always thought this is the
20 corporate attorney is the business side, and the personal,
21 you know, is very different, really, you know. And I
22 thought we had paid so many taxes it's all included.

23 Q Okay. Thank you.

24 MR. RILEY: That's all the questions I have for
25 Mrs. Vakilian. If we could turn to Mr. Starkey?

1 CROSS-EXAMINATION

2 BY MR. RILEY:

3 Q Mr. Starkey, can you hear me?

4 A I can.

5 Q Okay. Mr. Starkey, were you aware that the
6 Vakilians were the sole shareholders of Kriton
7 Corporation?

8 A I am.

9 Q On June 4TH, 2013, the Vakilians received what
10 you have previously described as the big payoff, the final
11 lump sum payment of the sale. Did you include income from
12 the big payoff on the Vakilians' 2013 personal return?

13 A I did not. It was all taxed through the
14 corporation.

15 Q Okay. The taxpayer's opening brief claims you
16 were aware that the money distributed to the Vakilians in
17 2013 was not a dividend, and that the corporation was
18 distributing its remaining cash and dissolving. Is this
19 what you told the auditor in May 2016?

20 A Yes.

21 Q In May 2016, did you believe that the funds the
22 Vakilians had withdrawn from Kriton in 2013 were a
23 dividend?

24 A I believe they had already been taxed to the
25 corporation and would go tax free to the Vakilians.

1 Q Okay. Do you recall telling the auditor, in a
2 corporation the only way to take money out is through
3 payroll, loan repayment, or dividend, so that's what they
4 did?

5 A That's correct.

6 Q You stated on May 3rd, 2016, that you prepared
7 the payroll, payroll taxes, payroll reports, and tax
8 preparation. Did you also prepare a Form 1099 DIV for the
9 shareholders?

10 A I did not.

11 Q On August 16th, 2013, weren't you under the
12 impression that the effect of the corporate liquidation
13 impacted either the corporation or the shareholders but
14 not both?

15 A Yes. I thought it only affected the corporation.

16 Q And so this is what you told the auditor on
17 August 16th, 2016?

18 A Yes.

19 Q And did you prepare the -- well, I've asked that.
20 Sorry.

21 Were you familiar with Internal Revenue Code
22 Section 331 at the time you prepared their personal return
23 for the 2013 taxable year?

24 A Yes, I am.

25 Q What about Section IRC Section 334? Were you

1 familiar with that at the time you prepared their return?

2 A Yes, I am.

3 Q Did you review either Section 331 or Section 334
4 at the time you prepared their personal return?

5 A I did not.

6 Q Did you believe the statute was incorrect,
7 Section 331?

8 A No, I did not. No.

9 Q Okay. Did you inform the Vakilians that the
10 statute was incorrect, Section 331?

11 A No, I did not.

12 Q Did you tell the auditor on August 16th, 2016,
13 that there will likely be an adjustment at the shareholder
14 level as they failed to report the liquidating -- the
15 liquidation distribution per IRC Section 331?

16 A Can you repeat that question, please?

17 Q Yes. Apologies if I spoke quickly. Did you tell
18 the auditor on August 16th, 2016, that there will likely
19 be an adjustment at the shareholder level as they failed
20 to report the liquidating distribution as per IRC
21 Section 331?

22 A Yes, I think so. I can't really recall.

23 Q Okay. After learning from the auditor that the
24 shareholders treatment was incorrect, on what date did you
25 inform the Internal Revenue Service that the Vakilians had

1 failed to report the liquidating distribution pursuant to
2 Internal Revenue Code Section 331?

3 A I did not.

4 Q So you -- so is it correct that you did not file
5 an amended federal return to report the shareholders
6 additional tax from the liquidating distribution for the
7 2013 taxable year?

8 A That's correct.

9 Q Based on what you have since learned about
10 liquidating distributions, did the Vakilians pay the
11 correct amount of state or federal tax for the 2013
12 taxable year?

13 A They did not.

14 Q For the 2013 personal return, did the Vakilians
15 provide you with documentation to prove their basis in
16 Kriton Corporation or the service station?

17 A Yes, they had.

18 Q Do you recall the amount of what that basis
19 amounted to?

20 A I think it was around -- I think it was
21 \$2 million.

22 Q Did you record that amount anywhere on the
23 Vakilians' personal return for 2013?

24 A I did not.

25 MR. RILEY: Okay. Thank you, Mr. Starkey.

1 Those -- that is all the questions that I have.

2 JUDGE AKOPCHIKYAN: Thank you, Mr. Riley. I'll
3 turn it over to my Panel members to see if they have any
4 questions for the witnesses.

5 Judge Andrea Long, any questions?

6 JUDGE LONG: This is Judge Long. I have no
7 question.

8 JUDGE AKOPCHIKYAN: Thank you.

9 Judge Leung, any questions?

10 JUDGE LEUNG: Yes, I do have some questions
11 for -- let's start with Mr. Starkey.

12 Clarification, if you may. The sale of the gas
13 station, was it a sale of the assets of the corporation,
14 or was it a sale of the ownership interest in the
15 corporation?

16 MR. STARKEY: In my mind it was a sale of the
17 assets. The corporation was still active. It was still
18 ongoing. It still had a bank account. It still
19 functioned. I actually closed out the corporation in 2013
20 after the final payment. So in my eyes it was completely
21 still in operation, and that's why I continued to do it by
22 paying and putting the Vakilians on payroll.

23 JUDGE LEUNG: Okay. But on paper was it a sale
24 of the assets or a sale of the ownership interest?

25 MR. STARKEY: Again, I think I've already

1 answered that. It was the sale of the assets.

2 JUDGE LEUNG: Okay. So if that's the case, then
3 you're saying the Franchise Tax Board -- then in your mind
4 you did not under pay the taxes?

5 MR. STARKEY: Well, that's exactly right. I did
6 everything through the corporation because the corporation
7 was still ongoing. I put them on payroll to lessen the
8 capital gains rate, although they did pay payroll taxes on
9 it. And the whole idea is when the corporation finally
10 got paid off which -- again, when this started, we didn't
11 know if it was even going to get paid off.

12 We were very concerned about the iffiness of
13 that. But when it did get paid off, in my eyes I took the
14 total sale price minus the basis of it as the assets, did
15 all the entity through the corporation, and the stock was
16 worthless on their personal side. They didn't sell the --
17 they didn't get anything for the stock. So therefore, I
18 didn't address the stock on the personal return at all.

19 JUDGE LEUNG: And for civil purposes, did you
20 treat the sale of the assets as a bulk sale?

21 MR. STARKEY: I'm sorry. I didn't quite hear
22 that.

23 JUDGE LEUNG: Did you treat the sale of the gas
24 station's assets as a bulk sale?

25 MR. STARKEY: Well, I took it as an installment

1 sale. I took part of it for the monies they received in
2 2012 and the final of it in 2013. And they paid a
3 quarter-of-million dollars in tax in 2012, and they paid
4 half-a-million dollars in tax in 2013 on the sale of
5 Kriton Corporation. And I had no -- other than their
6 payroll and the W-2s that went to their personal side,
7 there was no gain on the personal side.

8 And it wasn't until I went through the audit with
9 Mr. Garcia that it came to my attention that perhaps I had
10 made a mistake. I wasn't convinced that I made a mistake,
11 but I thought there was a possibility of it. And that's
12 why I went and sought other legal counsel to find out what
13 would be the best move for the Vakilians.

14 JUDGE LEUNG: And was there a sales contract for
15 the sale of the gas station?

16 MR. STARKEY: Well, I'm sure there was an
17 installment note somewhere. Yes.

18 JUDGE LEUNG: I asked if there was a sales
19 contract for the sale of the business.

20 MR. STARKEY: All right. Yes. I'll have to say
21 I don't know.

22 JUDGE LEUNG: So you were never shown a sales
23 contract?

24 MR. STARKEY: Well, I don't recall seeing a sale
25 of contract. And part of the reason I would say that is I

1 thought the business was sold for \$5 million, and I find
2 out in the audit that it was actually sold for \$5.1. So I
3 don't know if I ever saw a contract because I wouldn't
4 have put \$5 million sale if it was \$5.1.

5 JUDGE LEUNG: If in your mind this is a sale of
6 the gas station's assets, was any sales and use tax paid
7 on those assets that were sold?

8 MR. STARKEY: There was only income tax paid on
9 those assets.

10 JUDGE LEUNG: Okay.

11 MR. STARKEY: Corporate tax.

12 JUDGE LEUNG: And for federal income tax
13 purposes, you treated it the same way as a sale of assets?

14 MR. STARKEY: Yes.

15 JUDGE LEUNG: And you treated the -- you had the
16 Vakilians as employees and paid them a salary for federal
17 income tax purposes and had the proper withholdings,
18 income tax and FICA withholdings?

19 MR. STARKEY: Yes. And the reason I did that
20 was, again, to lessen the amount of income that was coming
21 in from the installment sale payment so I could reduce the
22 tax that way by putting them on payroll. So, again, in my
23 own mind I had a plan to help the Vakilians save some tax
24 money.

25 JUDGE LEUNG: Getting to the point of saving them

1 some tax money, if this was an actual sale of the
2 Vakilians of their ownership interest, which would result
3 in capital gains on the federal side, would it have been
4 more advantageous for them to treat it as a sale of the
5 assets or treat it as the sale of the ownership interest?

6 MR. STARKEY: Well, that's a great question. I
7 analyzed it based upon if I could keep it all at the
8 corporate level and do all the entity at the corporate
9 level and pay the taxes at the corporate level, I thought
10 that was in their best interest.

11 JUDGE LEUNG: Thank you, Mr. Starkey.

12 Ms. Vakilian, good morning. When you said you
13 handed all the information regarding the sale to
14 Mr. Starkey to prepare the return, did you give him the
15 copy of the sales contract?

16 MRS. VAKILIAN: To the best of my knowledge, I
17 did. You know, there was, of course, a sales contract,
18 you know. We had a real estate agent and there was a
19 sales contract, you know. I -- yeah. To my best of my
20 knowledge, I gave him everything that I had.

21 JUDGE LEUNG: And in your mind, was it the sale
22 of your ownership interest in the corporation, or was a
23 sale of the gas station assets?

24 MRS. VAKILIAN: Well, this was -- this was the
25 gas station assets, you know. But, of course, the gas

1 station was Kriton Corporation, you know. I mean,
2 initially it was a sole proprietorship in 2003 when we
3 bought the old gas station and we already had to sign a
4 contract with ARCO that we would raze and rebuild at great
5 losses to us. And in 2005 it was Kriton Corporation then.
6 When the station opened, it's reopened under Kriton
7 Corporation.

8 JUDGE LEUNG: Okay. So you were -- were you
9 like -- well, maybe you could educate me about how gas
10 stations and major oil companies how they worked. Were
11 you like solely like a franchisee of ARCO?

12 MRS. VAKILIAN: Yeah. Right. I was a franchisee
13 under ARCO. And basically, you know, you sign your life
14 away, if you don't mind me saying that because there are
15 so many rules and regulation that we were unaware of. And
16 Kriton already had the plans for that new station for 10
17 years by the time we came along.

18 And so this is what happened. You know, we had
19 to -- you know, we had to abide by everything that ARCO
20 wanted us to do. And I was the franchisee. At that time
21 there were even exams. You had to pass certain tests in
22 order to become a franchisee. You had to be, you know, a
23 U.S. citizen, of course, you know. And there were all
24 kinds of requirements at that time. But --

25 JUDGE LEUNG: And --

1 MRS. VAKILIAN: Yeah. I'm sorry.

2 JUDGE LEUNG: Go ahead. I'm sorry. I'm sorry.
3 Go ahead.

4 MRS. VAKILIAN: Yeah. I mean, we had lots of
5 opportunity, you know, later on when we were trying to
6 sell the gas station. A lot of people wanted to buy the
7 gas station but there also was no -- you know, the bank
8 situation had at that time had changed. People could not
9 get any loans anymore, or people were not U.S. citizens.
10 There were all kinds of requirements.

11 So it was very difficult to sell the gas station,
12 really, at that point. Now, that's just beside -- besides
13 the point, just thinking about it, you know, brings a lot
14 of, you know, bad memories, really. But back to your
15 question, yes, I would say, you know, it was the -- I
16 mean, it was the assets that were sold. It was the gas
17 station that was sold at that time.

18 JUDGE LEUNG: Did ARCO have to approve that sale?

19 MRS. VAKILIAN: Oh, yes. ARCO has, and ARCO can
20 deny any sale and you have no right to litigation or
21 nothing, you know. And if you -- I mean, yes, they have
22 the first right. It was very complicated.

23 JUDGE LEUNG: So when ARCO approves a sale, does
24 their rules allow the sellers like yourself to keep the
25 corporation or somehow have a continuing role in the

1 corporation? Or does ARCO say, you've sold the gas
2 station. You are now out of the gas station business.

3 MRS. VAKILIAN: Right.

4 JUDGE LEUNG: We now deal with the new buyer.

5 MRS. VAKILIAN: Exactly. This is how it is.
6 Yeah. And the gas station then, you know, will be taken
7 over by the new buyer under another corporation.

8 JUDGE LEUNG: And did they have to train the new
9 buyers like they had to train you and your husband, all
10 that stuff?

11 MRS. VAKILIAN: Well, the training basically
12 happens, you know, by the previous owner. And, of course,
13 you know, the new owner has to go through a certain
14 training also. But a lot is on the job training and
15 really, you know, learning firsthand what needs to be done
16 and going to -- going to training sessions. And they
17 have, you know, supervisors all the time to check on you.
18 And that has to be done.

19 There's lots of regulations, you know, that have
20 to be in place when you have a gas station. It's not an
21 easy business. I learned the hard way.

22 JUDGE LEUNG: Well, I thank you so much for your
23 answers, Ms. Vakilian, and it's been very helpful. Thank
24 you.

25 MRS. VAKILIAN: Sure. At any time.

1 JUDGE AKOPCHIKYAN: Thank you.

2 I have a quick question for Ms. Vakilian.

3 You indicated that you assisted with training
4 after the sale. I understand that the sale happened in
5 February of 2012. How long did you provide training to
6 the new buyers?

7 MRS. VAKILIAN: I would say we were involved for
8 at least six months going back and forth and then more
9 sporadically. But being there on-site, yeah, for about
10 six months and then by telephone. And we stopped by and
11 they called us for advice also. And like I said, you
12 know, again, I have to come back to that death in their
13 family. You know, it was extremely difficult for them to,
14 you know, open a new business, not know all the know-hows,
15 and then, you know, deal with that family member who
16 suddenly passed.

17 We were there. Yeah, for six, I would even say
18 six to eight months, you know, going back and forth,
19 driving back and forth, staying there, being there
20 overnight so that we could be there early in the morning
21 to help out, you know. That was ongoing for a long time.
22 I felt we sold the business and now we do this all on our
23 own without compensation. You know, we were just, you
24 know, basically trying to help out. That was our goal to
25 help them make it run.

1 JUDGE AKOPCHIKYAN: Okay. Thank you for your
2 response. I don't have any other questions.

3 Give me one moment. I'm going to check with our
4 technology team if -- or our stenographer if we should
5 take a few minutes for a break. Yeah. Okay. We're good
6 to proceed.

7 For the Franchise Tax Board, please proceed when
8 you are ready.

9 MS. DEWEY: Thank you, Judge.

10

11 PRESENTATION

12 MS. DEWEY: Good morning. My name is, again is
13 D'Arcy Dewey, and I'm here with Bradley Kragel and Jason
14 Riley representing Franchise Tax Board. We will address
15 the two issues on appeal. I will address Kriton
16 Corporation's officer compensation issue, and Mr. Riley
17 will address the reasonable cause and good faith basis to
18 abate the accuracy-related penalty.

19 As we've seen the Vakilians were the sole
20 shareholders and officers of Kriton, which was a
21 subchapter C corporation for Kriton. They owned and
22 operated an ARCO service station and an AMPM Market.
23 Mr. Vakilian was Kriton's president and Mrs. Vakilian was
24 the CFO. In February of 2012, the Vakilians sold Kriton's
25 service station and store on an installment basis. After

1 the sale Kriton had no operating businesses, and its
2 installment note was its only business asset.

3 The Vakilians who, until the sale, paid
4 themselves twice monthly, made their last compensation
5 payments of \$5,000 on February 26th of that year. They
6 did not pay themselves again until December of 2012. At
7 that time they took lump payments of \$100,000 each.
8 Kriton deducted these payments as officer compensation and
9 did not report any corporate distributions for the tax
10 year. In June of 2013, the buyers paid off the
11 installment obligation. After this date, the Vakilians
12 withdrew all of Kriton's remaining cash and completed
13 liquidation of the corporation.

14 They dissolved Kriton in December of 2013. And
15 this is all in our briefs. Kriton deducted \$370,000 as
16 withdrawals as officer compensation and reported
17 approximately \$2.1 million in distributions. The
18 Vakilians failed to report any portion of the
19 distributions on their own taxable income.

20 Turning to the first issue, California law
21 provides the deduction for reasonable compensation. To
22 take the deduction, Appellants must prove that the
23 compensation was both reasonable and made purely for
24 services. These are factual determinations. Even if
25 compensation is deemed reasonable, Respondent may disallow

1 a deduction where the facts indicate that the compensation
2 was disguised as dividends or distributions. In this
3 case, the evidence shows that the compensation was both
4 unreasonable and not paid solely for services, in other
5 words, disguised equity distributions.

6 The Ninth Circuit applies a five-factor test for
7 reasonable compensation. The first factor looks at the
8 employee's role in the company, including hours, duties,
9 contribution to the corporation's success. In this case,
10 after February 2012, the Vakilians no longer had a
11 business. Despite this, they gave themselves a 25 percent
12 raise in 2012 and a 48 percent raise in 2013. This factor
13 indicates that the compensation was unreasonable. The
14 Vakilians did submit statements, and we heard
15 Mrs. Vakilian speak today claiming that they paid
16 themselves for training the new business owners in 2012
17 and for collecting installment payments.

18 They assert that Mrs. Vakilian worked part-time
19 for about three months in their statements. I'm referring
20 to their statements that they submitted. She worked about
21 three months part-time, and Mr. Vakilian worked for
22 approximately six months, at least some of which was
23 part-time. And they may have worked on-call thereafter
24 via the telephone, according to Mrs. Vakilian today.
25 Appellants did not submit any evidence of the services or

1 of when the services were actually rendered.

2 In this case, Appellants' unsupported assertions
3 do not meet their burden of proof. The purchase agreement
4 does not contain provisions for the Vakilians' services,
5 and Appellants did not produce evidence, such as emails or
6 third-party statements supporting their assertions.
7 Furthermore, even if we do accept the Vakilians'
8 statements, their pay increases were not reasonable given
9 that their workload apparently dropped to part-time hours
10 only and decreased substantially over time. Appellants
11 did not claim that they provided services to the buyers in
12 2013 at all. Appellants' failure to prove that the
13 Vakilians provided services also strongly suggest that the
14 payments were distributions in addition is unreasonable.

15 The second factor considers compensation paid by
16 other companies for like services. This is a specific
17 inquiry into what would ordinarily be paid for like
18 services, by like prices, under like circumstance. Here
19 Appellants would need to show what a former service
20 station company paid its executives following the sale of
21 the business. Appellants submitted figures from the
22 bureau of labor statistics for median wages paid to chief
23 executives and top executives in all industries throughout
24 the United States in 2020. These figures are too broad to
25 meet the like pay test and, therefore, this factor is

1 neutral.

2 The third factor looks at the character and
3 condition of the company, including the size of the
4 company measured by sales, net income, capital value, the
5 complexity of the business, and the general economic
6 conditions surrounding that business. Again, the payments
7 were made at a time when Kriton's business activities
8 consisted of collecting passive income. It was not a
9 complex business at that point. Even though the company
10 had significant net income from the sale, it had no
11 operating receipts. Appellant did not show that the
12 Vakilians were required to work to ensure the payment of
13 the installment payments at that time.

14 You just heard Mrs. Vakilian say that they had
15 received monthly payments. They offered no evidence that
16 the buyers defaulted on the payments or were likely to
17 default on the payments. And, in fact, the buyers paid
18 off the notes early in 2013. This factor indicates that
19 the compensation was unreasonable and not in exchange for
20 services.

21 The fourth factor looks at whether there was a
22 conflict of interest between the company and the employee.
23 The conflict of interest will always exist between a
24 company and its sole shareholders and their family
25 members. There is incentive for any company and

1 shareholders in this situation to take equity out through
2 deductible compensation instead of dividends. In these
3 cases then, inquiry is into whether a hypothetical
4 independent investor would be satisfied with the rate of
5 return after compensation is paid.

6 Here Kriton realized large gains upon the sale of
7 the service station representing large returns for the
8 hypothetical investor and the Vakilians themselves.
9 However, the evidence shows that instead of making a
10 business decision to compensate its officers, Kriton
11 treated these payments as compensation to late year tax
12 planning strategy. Appellants' tax preparer just spoke to
13 us and indicated specifically that he had the Appellants
14 pay themselves a salary as a tax planning strategy.

15 During audit he submitted the following
16 statement. "Very late in 2012 and after every payment had
17 been made, the Vakilians took paychecks and paid payroll
18 taxes on the money they had received. After all, they
19 were still working protecting their interest in the two
20 notes and running back and forth to Los Angeles regularly.
21 And in the corporation there is only one way to take money
22 out is through payroll, loan, repayment, or dividends.
23 And that's what they did."

24 It goes on to say that, "finally at some point in
25 2013 the Vakilians received the final lump sum payment on

1 the sale. So for 2014, I had them take a salary, pay the
2 taxes on the salary, et cetera."

3 This statement together with Mr. Starkey's
4 statements today clearly indicates that they did not pay
5 themselves as officers in the corporation but as a tax
6 strategy to reduce their capital gain. An independent
7 investor would not agree to defray its investment returns
8 by paying salaries not actually owed. This factor
9 indicates that compensation was not reasonable and not for
10 services rendered.

11 The fifth factor looks at internal consistency of
12 the company's compensation within. In this case, Kriton's
13 pay journals indicate that Kriton paid its officers twice
14 monthly until just following the sale. And then it paid a
15 large lump sum at the end of 2012 and in the third quarter
16 of 2013. This break in consistency of payments shows that
17 the payments were not reasonable and not solely for
18 services. The balance of these factors shows that
19 Kriton's officer compensation payments were not reasonable
20 and, in fact, were disguised equity distributions.

21 In addition to the five-factor, there are factors
22 that specifically indicate that the payments were equity
23 distributions. For example, in the first year of the
24 sale, Kriton failed to report any dividends. Instead, it
25 reported all the Vakilians' withdrawals as compensation.

1 Failure to report dividends in a year with large returns
2 can suggest the compensation was a dividend.

3 Second, Kriton paid Mr. and Mrs. Vakilian equal
4 amounts consisting with their -- consistent with their
5 ownership interest in the corporation even though the
6 Vakilians claimed that Mr. Vakilian provided more services
7 than Mrs. Vakilian in 2012. Where the amount of the
8 payment with respect to equity interest rather than the
9 value of services, the payment is likely a distribution.

10 In their reply brief, Appellants argue that the
11 compensation was somehow for past service as a reward for
12 closing the deal. Corporations may compensate employees
13 for past services, but taxpayers have the burden to show
14 that the payment was intended for that reason. The Ninth
15 Circuit has refused to give credit to claims made as an
16 afterthought once the compensation is under review.

17 In this case, Appellants did not submit any
18 evidence to prove their claims. Furthermore, Appellants
19 first introduced this argument in their reply brief on
20 appeal. For these reasons, Kriton's compensation was
21 disguised as distributions. Respondent respectfully asks
22 the Panel to sustain its determination disallowing
23 Kriton's compensation deduction.

24 Thank you.

25 And now I'll turn it over to Mr. Riley.

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1 in dispute. Based on the disputed tax of this amount is
2 clearly in excess of 10 percent of the tax required to be
3 shown on the return. Appellants' understatement of tax
4 was substantial under the law, and Respondent has met its
5 burden.

6 The accuracy-related penalty based on Appellants'
7 substantial understatement amounts to \$44,081.80. The
8 imposition of the accuracy-related penalty is in dispute
9 in this appeal, and it's Appellants' burden to prove their
10 asserted defense of reasonable cause and good faith. A
11 reasonable cause defense requires a taxpayer who is
12 otherwise liable for the accuracy-related penalty to prove
13 that they have reasonable cause for a portion of the
14 underpayment, and that they acted in good faith with
15 respect to that position.

16 Whether the Vakilians acted with reasonable cause
17 and in good faith depends on their efforts to access their
18 proper tax liability, their knowledge and experience, and
19 the extent to which they relied on the advice of a tax
20 professional. The tax advisor must have been a competent
21 professional who had sufficient expertise to justify
22 reliance.

23 First, Appellants' reply brief states that their
24 tax professional, Mr. Starkey, provided no actual advice
25 and produced no contemporaneous records of any advice.

1 Rather, they argue that by merely preparing the 2013
2 return, he provided, quote, "implicit advice." Mere
3 preparation of a return does not constitute advice. An
4 omission is not advice. An omission is not analysis or
5 conclusion. Implicit advice, that which is left unsaid
6 and un-communicated is insufficient to avoid the
7 accuracy-related penalty.

8 At today's hearing, Appellants argued Mr. Starkey
9 gave the taxpayers, quote, "explicit advice." The record
10 does not reflect this. Mr. Starkey's May 2016 statement
11 indicates that he did not include the proceeds from the
12 sale of the service station and subsequent withdrawal of
13 these proceeds from Kriton Corporation in the Vakilians'
14 California income for 2013. The May 2016 statement also
15 indicates Mr. Starkey believed the income to be a
16 dividend.

17 As of August 16th, 2016, when Respondent's
18 auditor informed him of the law, Mr. Starkey was unaware
19 that the law required tax on liquidating distribution at
20 the shareholder level. Upon learning that the Vakilians
21 had failed to report liquidating distribution at the state
22 level, neither Mr. Starkey nor the Vakilians informed the
23 IRS in good faith that the shareholders had similarly
24 failed to report the income on a federal level.

25 Substantive advice is the requirement.

1 Appellants have not demonstrated that Mr. Starkey provided
2 Appellants with substantive advice at the time the return
3 was filed. Substantive advice must reflect the advisor's
4 analysis or conclusion. None of the documentation
5 Mr. Starkey provided in 2016 reflects his analysis or
6 conclusion that the statute was incorrect. He was unaware
7 of the applicable statutes and was incorrect on the tax
8 that the Vakilians owed.

9 While he was an enrolled agent, his failures
10 indicate that at the time he filed their 2013 return, when
11 he had been an enrolled agent for five years, he did not
12 have sufficient expertise for the Vakilians to justify
13 reliance in this tax matter.

14 Regarding documentation, Appellants did not
15 substantiate their basis in the service station during the
16 audit. And while they provided some documentation to
17 substantiate a little over a million dollars of basis
18 during the appeal, Appellants have not demonstrated that
19 they furnished Mr. Starkey with this data at the time he
20 filed their 2013 return. And there is no indication of
21 their basis in Kriton on their 2013 personal return.

22 As for their effort, Vakilians were the president
23 and chief financial officer of a corporation, and they
24 failed to prove sufficient effort to assess their proper
25 tax liability. The \$2 million in gain above their basis

1 represented a major amount for the Vakilians. The money
2 Mrs. Vakilian received on June 14th, 2013, was the big
3 payoff of the service station, a major amount of income
4 that they had been waiting for. They immediately withdrew
5 \$1 million and withdrew another \$1.7 million during July
6 and August of 2013.

7 These were the liquidating distributions and were
8 taxable to the Vakilians. The Vakilians had a duty to
9 review and file an accurate return. A reasonable review of
10 their return to ensure all income items were included or
11 even simply the major income items should have revealed an
12 omission as straightforward and substantial as \$2 million
13 of their income for 2013. That the \$2 million from the
14 liquidating distribution was completely omitted from their
15 2013, should have given the taxpayer pause, as it would
16 for any reasonable person.

17 It doesn't take a second opinion from a different
18 tax professional to spot a missing \$2 million in income.
19 And for the corporation's CFO, the officer with control
20 over the corporate bank account who personally accepted
21 the monthly installment payments, the wire transfers for
22 the big payoff, and oversaw withdrawal of the liquidating
23 distributions from the corporation is not reasonable that
24 she could have missed the substantial understatement of
25 tax.

1 Mr. Starkey did not provide advice that could be
2 reasonably relied upon. He did not have the required
3 documentation to report the Vakilians basis, nor did he
4 have sufficient expertise to justify reliance at the time.
5 The accuracy-related penalty is mandated in this case and
6 should be sustained by the Panel.

7 Thank you. And this concludes Respondent's
8 argument, and we are happy to answer any of the Panel's
9 question.

10 JUDGE AKOPCHIKYAN: Thank you.

11 Turning over to my Panel member.

12 Judge Long, any question for Franchise Tax Board?

13 JUDGE LONG: This is Judge Long. I have no
14 questions. Thank you.

15 JUDGE AKOPCHIKYAN: Judge Leung, any questions
16 for Franchise Tax Board?

17 JUDGE LEUNG: I think I'm going to wait until the
18 taxpayer completes his final statements, his final
19 comments before I ask any questions to the Franchise Tax
20 Board. Thank you.

21 JUDGE AKOPCHIKYAN: Thank you.

22 I don't have any questions at this time.

23 Mr. Waldron, please proceed with your closing
24 remarks when you are ready.

25 ///

1 CLOSING STATEMENT

2 MR. WALDRON: Yeah. Yeah. Yeah. There are just
3 a couple of points I did want to respond to.

4 I think Jason -- our brief does say that explicit
5 advice was provided. I think it was in our second reply.
6 But I just want to make sure that's clear that we say that
7 explicit advice was provided, but for the sake of
8 argument, assuming it wasn't or it couldn't be proven,
9 implicit advice is also okay. And so I just want to make
10 sure that was clear.

11 I think Judge Leung's questions to Frieda show
12 that -- and to Steve shows a very complex transaction, and
13 there was a lot going on. I think Jason mention -- well,
14 I think Jason mentioned that Steve was an E.A. for five
15 years, but he had been preparing tax returns since 1980
16 and was an E.A. since 1988. So I just want to make sure
17 that was clear.

18 The advice -- the advice was substantive. This
19 is not -- it's not -- it's not capital gain from their
20 Apple stock that's in their Merrill Lynch account, you
21 know, that Steve missed on the 1099 B and did not report
22 on the capital gain. This capital gain requires analysis,
23 conclusions, and advice.

24 And I think this is the first time I've heard FTB
25 say that not everything or possibly not everything was

1 provided, but I think we've already shown that everything
2 was provided. And finally, I think the question just
3 highlight that they relied on advice and that they were
4 not required to challenge Steve's advice or ask him for an
5 opinion letter or treaties on how he came up with these
6 conclusions on no capital gain.

7 And that's it.

8 JUDGE AKOPCHIKYAN: Thank you, Mr. Waldron.

9 MRS. VAKILIAN: May I say something?

10 MR. WALDRON: Frieda, yeah.

11 MRS. VAKILIAN: Yeah. Frieda Vakilian. I'd just
12 like to say something.

13 This situation has been absolute agony for me and
14 my husband. It has been ten years of our life that has
15 been consumed by this. I never felt I did anything wrong.
16 I understand that I should have been more prepared asking
17 questions, and my naivete I didn't do. But I definitely
18 want to state here that I never felt I did anything wrong
19 in this situation. We always pay our taxes. We always
20 felt we did everything by the book. And that is I need --
21 I just felt I need to say that.

22 It has been ten years. Long ten years. In the
23 meantime I'm -- I want to move on. Like I said, I am a
24 grandmother. I am a cancer survivor. I want to be happy
25 and put this behind me. But, definitely, it has been a

1 difficult time. All these ten years in the back of my
2 mind, when will this finally end? And I hope it will be
3 ending today. I guess it will be. But I'm only a human
4 being and, you know, this has been a difficult time for
5 everybody involved in this, really.

6 And thank you very much for listening. I
7 appreciate it. Thank you.

8 MR. WALDRON: Thank you very much. That's it.

9 JUDGE AKOPCHIKYAN: Thank you, Mrs. Vakilian, for
10 your statement.

11 I'm turning over to my Panel members for any
12 final questions.

13 Judge Long, any questions for the either party?

14 JUDGE LONG: This is Judge Long. No questions.
15 Thank you.

16 JUDGE AKOPCHIKYAN: Thank you.

17 Judge Leung, and questions for either party?

18 JUDGE LEUNG: Yes, for the Franchise Tax Board or
19 either -- anybody on the Franchise Tax Board.

20 We know the taxpayers reported about \$570,000 in
21 salary over two years and paying California taxes for
22 that. That was for, I guess, compensation. Was the tax
23 that they paid taken into account in your calculations for
24 current NPAs in today's appeal?

25 MS. DEWEY: I can speak to that. Yes. Yes, the

1 adjustment to their return for the 2013 year accounts for
2 the fact that they already reported the \$370,000 in
3 officer compensation. And because compensation and
4 capital gains are not taxed differently, there was no tax
5 effect for that amount.

6 JUDGE LEUNG: I just want to make sure that
7 they're not being taxed again on income they would have,
8 you know, for both their compensation and for purpose of
9 computing the dividend distribution as you guys have
10 prescribed it. And I know Mr. Riley mentioned that, you
11 know, \$2 million is a big number to miss. Refresh my
12 memory, please. Is there a 1099 issued for those payments
13 as they come -- as they are paid on the installment
14 agreement?

15 MR. RILEY: This is Jason Riley. Sorry. I muted
16 myself again. Yeah. As Mr. Starkey stated, he never
17 prepared a 1099 for the distribution from Kriton
18 Corporation to the Vakilians, to the shareholders.

19 JUDGE LEUNG: Be that as it may, did Kriton or
20 the Vakilians receive a 1099 from the buyer when they made
21 the -- especially the big lump sum payment in 2013? Was
22 there a 1099 issued? Or should there have been?

23 MS. DEWEY: For the asset sale?

24 JUDGE LEUNG: Well, however you would
25 characterize that. As an asset sale or stock sale, would

1 there be a 1099 issued by the buyer for any of those
2 installment payments.

3 MS. DEWEY: I think we would have to get back to
4 you on that one. I don't have the answer in front of me
5 right now. I don't have it off the top of my head.

6 I don't know about you, Jason or Brad.

7 But there's no evidence in the record of a 1099,
8 and we didn't pursue that avenue of investigation.

9 JUDGE LEUNG: Okay.

10 MR. RILEY: Oh, I think with the respect to the
11 1099 -- the 1099 DIV, it's -- it's on the corporation.
12 You know, if you make a payment that may be a dividend but
13 you're unable to determine whether any part of that
14 payment is a dividend by the time you must file the 1099
15 DIV, the entire payment must be reported as a dividend
16 to -- these -- the 1099 DIVs, they look like the
17 corporation would issue them to the shareholders.

18 And while they are one and the same, you know, we
19 asked Mr. Starkey about -- he had stated that he had
20 prepared the payroll, payroll taxes, payroll reports, the
21 tax preparation, and asked him whether he had prepared a
22 1099 DIV also for the corporation at -- to the
23 shareholders. And, again, he said that he did not.

24 JUDGE LEUNG: Understood that part. I'm
25 inquiring about the buyers issuing the 1099, not Kriton

1 Corporation, the buyers who actually did payoff on the
2 sale. But as Ms. Dewey says, she doesn't quite know
3 whether there's an actual requirement and she needs to get
4 back to us on that.

5 One final question on reasonable cause. And you
6 won't find this in the federal tax cases and tax analysis.
7 It's strictly a state question. Would the fact that the
8 IRS did not audit or adjust for this transaction, would
9 that in itself be reasonable cause?

10 MR. RILEY: In this instance two things, Judge.
11 In this instance, the IRS had no reason to know of it
12 because Mr. Starkey didn't discover that it was a
13 liquidating distribution until 2016 when Respondent's
14 auditor informed him of that. And according to the
15 federal transcript, which Franchise Tax Board submitted as
16 Exhibit RR, the final communication between -- on the
17 taxpayer's 2013 federal return was July 6th, 2015.

18 And so that is a -- that's a full year before --
19 before Mr. Starkey learned of it. So the IRS, if there is
20 no -- you know, if the taxpayer -- the taxpayers have
21 stated they didn't put anything regarding the sale. They
22 didn't say, hey, we sold it for \$3 million, but we also
23 had \$3 million in basis. Or they mentioned the
24 qualified -- the qualified -- the small business, the
25 QSBS, right.

1 You know, they didn't -- they didn't put anything
2 about the qualifying small business stock on the returns
3 that would have indicated to the IRS that there was
4 anything amidst.

5 JUDGE LEUNG: Okay. Thank you. I'm finished
6 with my questions. Thank you very much.

7 MR. WALDRON: I don't know if I'm permitted to
8 answer the questions about the 1099?

9 JUDGE LEUNG: Sure.

10 MR. WALDRON: The buyers did not issue a 1099.

11 JUDGE LEUNG: Okay. Thank you.

12 JUDGE AKOPCHIKYAN: All right. Thank you very
13 much.

14 Does either parties have any questions before we
15 conclude the hearing? Hearing none, we are ready to
16 conclude this hearing.

17 This case is submitted on March 24, 2023, and the
18 record is now closed.

19 I want to thank the parties for their
20 presentation today and Mrs. Vakilian and Mr. Starkey for
21 their testimony. The Judges will meet and decide this
22 appeal based on the arguments and evidence presented to
23 the Office of Tax Appeals. We will issue our written
24 decision no later than 100 days from today.

25 Thank you all. We will take a recess before the

1 next hearing, which is scheduled to begin at approximately
2 1:00 o'clock. Thank you.

3 (Proceedings adjourned at 11:10 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
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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 17th day
of April, 2023.

ERNALYN M. ALONZO
HEARING REPORTER