

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
M. REGISTER and A. REGISTER,) OTA NO. 220410208
)
 APPELLANT.)
)
)

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, May 18, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 3:00 p.m. and concluding at 4:04 p.m. on
Thursday, May 18, 2023, reported by Ernalyn M.
Alonzo, Hearing Reporter, in and for the
State of California.

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APPEARANCES:

Panel Lead: ALJ JOSH LAMBERT

Panel Members: ALJ JOSHUA ALDRICH
ALJ EDDY LAM

For the Appellant: TIMOTHY MCDONNELL
MICHAEL WILK

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

ALISA PINARBASI
MARIA BROSTERHOUS

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-11 were received at page 6.)

(Department's Exhibits A-F were received at page 6.)

P R E S E N T A T I O N

P A G E

By Mr. Wilk	8
By Ms. Pinarbasi	29

A P P E L L A N T ' S
W I T N E S S E S :

D I R E C T

C R O S S

R E D I R E C T

R E C R O S S

Mr. McDonnell	16
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C L O S I N G S T A T E M E N T

P A G E

By Mr. Wilk	36
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California; Thursday, May 18, 2023
3:00 p.m.

JUDGE LAMBERT: We are now on the record in the Office of Tax Appeals' oral hearing for the Appeal of Mark and Adrienne Register, Case Number 220410208. The date is May 18th, 2023, and the time is 3:00 p.m.

My name is Josh Lambert. I'm the Administrative Law Judge leading this hearing, and my co-Panelists are Judge Aldrich and Judge Lam.

FTB, can you please introduce yourselves for the record.

MS. PINARBASI: Hi. This is Alisa Pinarbasi for the Franchise Tax Board.

MS. BROSTERHOUS: Good afternoon. This is Maria Brosterhous, also for the Franchise Tax Board.

JUDGE LAMBERT: Hi. Thanks for attending the hearing.

And for Appellants, can you please introduce yourselves for the record.

MR. WILK: Yes. Good afternoon. My name is Michael Wilk of Lewis Brisbois Bisgard & Smith on behalf of the Appellants, Mark and Adrienne Register. And with me here today is our witness Mr. Timothy McDonnell, the CPA who prepared and filed the Register's 2020 income tax

1 return.

2 MR. MCDONNELL: Good afternoon.

3 JUDGE LAMBERT: Hi. Thanks for attending.

4 The issue in this hearing is whether the late
5 filing penalty should be abated.

6 FTB provided Exhibits A through F, and Appellants
7 provided Exhibits 1 through 11. There were no objections
8 to the exhibits, so those exhibits are now in the record.

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

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

13 So Mr. Wilk and Mr. McDonnell, this is your
14 opportunity to explain the Appellants position. I believe
15 that Mr. McDonnell is testifying as a witness. So during
16 the presentation he'll be testifying, so I could swear him
17 in right now, if that's okay.

18 MR. WILK: Yes, please.

19 JUDGE LAMBERT: Okay. Mr. McDonnell, can you
20 please raise your right hand.

21

22 T. MCDONNELL,

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 LAMBERT: Okay. Thank you.

2 And Mr. Wilk, you can proceed. You have
3 30 minutes. And afterwards, FTB will have the opportunity
4 to ask Mr. McDonnell questions as a witness, and the panel
5 will ask questions as well. So please continue. Thanks.

6 MR. WILK: Thank you. Rather starting with an
7 opening statement, Appellants and the Franchise Tax Board
8 have submitted briefs. And I presume that the Judges have
9 reviewed those briefs in advance of today's hearing. I
10 thought -- or I propose starting directly with the witness
11 testimony of Mr. McDonnell with your permission.

12 Additionally -- and again, this is Michael Wilk.
13 I apologize. You asked me to identify myself every time
14 we speak.

15 In addition, it's my understanding that the
16 testimony can either be by way of a narrative or by direct
17 examination, and we propose to proceed with the witness
18 testifying in a narrative fashion. And at the end of his
19 narrative if I believe that there are any issues or facts
20 that he's left out, I will pose direct questions to him.
21 Is that acceptable?

22 JUDGE LAMBERT: Yes. That sounds good, thanks,
23 if you're asking me.

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MR. MCDONNELL: Thank you, Michael.

First of all, in late November, December of 2020, we received income tax projections for the Registers. Those projections, which were submitted as part of our deposition hearing, indicated that there was no expected tax filing of their 2020 federal and California income tax return. In April and May of 2021, one of my staff attorneys provided a draft copy of the Registers' 2020 income tax return for purposes of submitting an extension request, which was due on May 15th of 2021.

We should note that the IRS and California provided a blanket extension of time to file and pay for

1 taxpayers from April 15th through May 15th as a result of
2 the complications surrounding the Covid-19 pandemic.

3 Excuse me.

4 I reviewed the extension request and e-filed it
5 on May 12, 2021. The extension request was submitted as
6 Exhibit 1 in the pretrial hearing statement. In reviewing
7 the extension request, I relied on the draft copy of the
8 tax returns as prepared by my staff, which was submitted
9 as Exhibit 3. I also relied on the projections that were
10 done in November and December 2020. Both the draft copy
11 of the tax returns and the projections indicated that
12 there were no taxes due, either for federal or California.

13 In late September, early October 2021, it became
14 evident to me that I was not going to be able to complete
15 all of my clients' tax returns for a timely October 15th
16 filing. Accordingly, I developed a triage of the
17 remaining tax returns to determine which tax returns I
18 will complete for a timely file and which tax returns
19 would be filed late based on the draft copies of the tax
20 returns prepared by my staff.

21 Since the draft copy and the projections of the
22 Registers' tax return reflected no tax due, I decided that
23 their tax returns would be filed late so that I can get
24 other tax returns that may have had a tax liability done
25 first. The logic was simply that if there was no tax due,

1 there would be no interest and/or penalties due. So to
2 speak, no harm, no foul. I did not communicate to the
3 Registers at this time that I would be filing their tax
4 returns late, again, because I did not think it would be
5 an issue.

6 Subsequent to October 15th, I started reviewing
7 and finalizing the tax returns that were being filed late.
8 At this time, I became aware of two issues with respect to
9 the Registers' California tax return that resulted in
10 significant taxes being due. The first issue was, the
11 sales of restricted stock were not properly accounted for
12 by my staff. The second issue was that California does
13 not follow the federal rules with respect to Internal
14 Revenue Code Section 179 in expensing of fixed asset
15 acquisition.

16 I then completed the tax returns for the
17 Registers and submitted them to them for discussion and
18 their authorizations to e-file. I did this on November
19 1st, 2021, two weeks after the extended due date. This
20 was the first time that I communicated to the Registers
21 that their tax returns were being filed late. The
22 Registers signed the e-file authorization forms, and the
23 tax returns were e-filed by my office. Taxes were paid on
24 November 4, 2021.

25 Shortly thereafter, in December 2021, the

1 Registers received Notice of Return Change from the
2 Franchise Tax Board assessing a late filing penalty of
3 \$70,875. A copy of that notice was also attached to the
4 prehearing conference statement, Exhibit 5. We then
5 proceeded with a notice -- shortly after receiving the
6 Notice of Return Change, we prepared and filed Form 2917
7 Claim For Refund. In the claim of refund we asserted that
8 the late filing was not the taxpayers' fault, that, in
9 fact, the taxpayers were not even aware that the tax
10 return was filed late until after the extended due date.

11 We indicated that the taxpayer relied on their
12 CPA to properly prepare and file their 2020 income tax
13 returns as they had done for the past many years. The
14 claim for refund was attached to the prehearing trial
15 statement as Exhibit 6. In January of 2022, the Franchise
16 Tax Board denied the claim for refund, which we also
17 attached to the prehearing conference statement as
18 Exhibit 7.

19 In response to the Franchise Tax Board's denial
20 of claim for refund, we submitted on behalf of the
21 Registers' an appeal with the Office of Tax Appeals.
22 Supplement to our submission of the appeal to the Office
23 of Tax Appeals, the Internal Revenue Service issued IRS
24 Notice 2022-36. IRS Notice 2022-36 essentially waived all
25 federal late filing penalties for 2019- and 2020-income

1 tax returns. The Registers received a refund of their
2 federal late filing penalty in September of 2022.

3 Lastly, as a result of severe winter storms,
4 flooding, landslides, and mudslides that occurred in many
5 California counties, the Internal Revenue Service granted
6 extensions of time to file and pay with respect to any tax
7 returns originally due from March 9th, 2023, through
8 October 16th, 2023, to October 26th -- to October 16th,
9 2023. In the news release issued by the Franchise Tax
10 Board on March 10th of 2023, the Franchise Tax Board
11 indicated that they would follow the IRS and grant a
12 similar extension.

13 And, although, not directly related to this case,
14 it does show that the Franchise Tax Board has reliance on
15 the Internal Revenue Service for granting of extensions.
16 In fact, on the Franchise Tax Board website, it indicates,
17 and I quote, "Extended deadlines to file, pay, and make
18 contributions, California follows federal extended
19 deadlines. There are extended deadlines for -- and first
20 bullet, filing tax returns, second bullet, paying income
21 tax, and third bullet, making contributions to a
22 traditional IRA or Roth IRA. These extended deadlines are
23 up to one year. And in parens, see IRS tax relief in
24 disaster situations, interest and penalties are cancelled
25 on the unpaid income tax for the length of any extended

1 deadline, period," end of quote.

2 Again, that was taken from the website of the
3 Franchise Tax Board.

4 Now, I would like to turn to the reasons for the
5 late filing. In short, it was a result of unprecedented
6 Covid-19 pandemic. On March 10th, 2020, Massachusetts
7 Governor Baker declared a state of emergency for the
8 Commonwealth of Massachusetts. It was the first of 69
9 Covid-19 related orders issued by the Governor in the
10 Commonwealth of Massachusetts. These orders impacted many
11 workplaces, including mine. They impacted many of my
12 individual and small business clients, for whom I seem to
13 be their first responder.

14 The Commonwealth recommended remote access work
15 environments, even though accountants were eventually
16 essential employees. My small office was not setup for
17 remote access. Additionally, I didn't want client files
18 with all the confident client information in them to leave
19 the office.

20 And lastly, the remote access is arguably the
21 number one target for cyber hackers, especially, for
22 clients with the -- especially for accountants with the
23 amount of sensitive client information that our files
24 contain. We were staggering our staff time to allow
25 social distancing, along with the Covid-19 orders by the

1 Commonwealth, such that we had only one staff person and
2 myself allowed in the office at any one time.

3 In my 45 years of practicing as a CPA, I've never
4 seen more demands for my time than my existing clients.
5 Again, mostly individual and small business clients for
6 which I seemed to be their first responder when it comes
7 to most anything business related. The Covid-19 pandemic
8 was, as some has referred to, the perfect storm. There
9 was no manual on how to handle it.

10 The rules changed daily. For example, the IRS
11 first extended 2019 tax returns for filing but not for
12 paying. They then changed to both filing and paying.
13 2019 tax returns were extended to July 15th. 2020 tax
14 returns were extended to May 15th. 2021 tax returns were
15 not extended at all. And then there were issues with
16 respect to all the state filings. Were they following the
17 federal rules or not? In the end, most did. But at
18 times, we didn't know.

19 The rules for PPP loans were constantly changed.
20 Employee retention credits changed constantly as well.
21 And, in fact, at first you could not get both a PPP loan
22 and an employee retention credit. That was later changed
23 that you could get both, but you couldn't use the same
24 wages for both. In March of 2021, Congress, in their
25 infinite wisdom, enacted a retroactive tax law change back

1 in January of 2020 in the middle of the 2021 tax season.

2 We were essentially put on hold while the IRS,
3 the states, including California, and our computer
4 software vendors had to reprogram all the software so we
5 could file accurate tax returns based on the retroactive
6 tax laws enacted by Congress. We were attending seminars
7 in the middle of our tax season. We had to constantly
8 keep an eye out for any changes in a world that seemed to
9 change by the minute.

10 The volume of phone calls and emails received by
11 clients with questions were never as great as it was over
12 the past three years. They questioned everything
13 regarding stimulus payments, of which there were three
14 different stimulus payments with three different amounts,
15 three different phase out calculations. There were
16 questions and requests for assisting clients with PPP
17 loans, EID loans, and lastly, the ever-changing employee
18 retention credits. In short, the demand for my time in
19 the last few years was never even close to what it was in
20 the last three years.

21 With that, I respectfully submit this to the
22 Office of Tax Appeals and the Franchise Tax Board for
23 their consideration. Thank you.

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Q This is Michael Wilk, counsel for the Appellants,
Mr. And Mrs. Register.

A Of course there were, and that's an ever-ending problem with the brokerage firms. You get a 1099 and invariably two weeks later get a corrected one. Okay. Well, the brokerage firms, just like the accounting firms, just like the Franchise Tax Board, just like the Office of Tax Appeals, we all had issues. Okay. So the brokerage firms were even later than they normally were in getting out 1099s and then getting corrected 1099s.

I just recently, about a month ago, got a corrected 1099 for 2021. Okay. In May, or April, I guess it was, in April 2023. So, yes.

A Absolutely. Not only did it all both tax my time, it made us very inefficient. You know, we had tax

1 returns done, ready to file, sent out to clients, and then
2 subsequently before the client returned the e-file
3 authorization forms, we get a corrected 1099. Okay. So
4 now we need to revise the tax return, send out a corrected
5 tax return to the client, and then get a new electronic
6 file authorization form to the client before we can e-file
7 the returns.

8 And then we had the other situation where the
9 other corrected brokerage forms arrived after the tax
10 returns were filed. Now we're faced with filing amended
11 tax returns if the amount of the change was significant.

12 Q Earlier you testified to various changes in the
13 tax laws, both at the federal and state levels. Did you
14 have to attend any seminars to inform yourself as to those
15 changes and the effects thereof?

16 A Yes, we did. We, my staff and myself, we've
17 attended many online seminars related to tax law changes.
18 I'm aligned with a particular group with the Connecticut
19 Society of CPAs that as emerging issues come up, they will
20 have a pop-up seminar almost immediately within a few
21 days. And we would attend them, and they would go
22 anywhere from 30 minutes to 4 hours.

23 Q Did these seminars and the time you had to spend
24 and your staff have to spend, impact or contribute to your
25 office's inability from May through October 15th, 2021, to

1 complete and file the Registers' tax returns?

2 A Absolutely. Like I said, everything that
3 happened during this perfect storm, this was a drain on my
4 time. And every tax return that goes out of this office
5 is reviewed in detail and signed by me. So the drain on
6 my time during this pandemic has been tremendous. And
7 being a small practitioner, a small practitioner, it's
8 even more difficult. I don't have a staff of 20 CPAs that
9 can help me. I don't have a partner that I can say, you
10 know, can you take on this client for me because I don't
11 have the time. So it was, all basically, rested on my
12 shoulders.

13 Q How long have you prepared the Registers' income
14 taxes?

15 A Interesting you say that. I looked back this
16 morning. I started preparing their returns in 2004.

17 Q Okay. And have the Registers timely filed their
18 California income tax returns throughout the entire period
19 of time that you've represented them and prepared
20 California returns for them?

21 A Yes. Yes. And they were not always California
22 taxpayers. They relocated to California a few years ago.

23 Q I understand. Do you have a best estimate as to
24 when they relocated to California and became California
25 taxpayers?

1 A I'm going to -- I'm going to guess approximately
2 five years.

3 Q All right. And during the period of time that
4 you prepared the tax returns -- income tax returns for the
5 Registers, have they at all times fully paid and timely
6 paid all taxes owed?

7 A Yes.

8 Q Has there ever been an audit by either the IRS or
9 the Franchise Tax Board of any tax returns submitted on
10 behalf of the Registers that you prepared?

11 Mr. McDonnell, did you hear me?

12 A Oh, I said, no. I'm sorry.

13 Q Okay. I apologize. I did not hear that.

14 Has there ever been a penalty imposed on the
15 Registers by the Franchise Tax Board or the IRS for either
16 any prior failure to timely file or failure to timely pay
17 their income tax returns -- income tax?

18 A There was not a penalty for failure to file
19 because we've always filed timely. There may have been a
20 failure to timely pay, but I don't know that without going
21 back in the last five years.

22 MR. WILK: Okay. With the permission of this
23 body and, Your Honors, Appellants submit the testimony of
24 Mr. McDonnell, and I have no further questions at this
25 time. And I am not sure of the procedure here, but it

1 strikes me that it would be appropriate at this time if
2 the Franchise Tax Board counsel have any questions for
3 Mr. McDonnell, that they should be allowed to ask those
4 questions now.

5 JUDGE LAMBERT: This is Judge Lambert. Does that
6 conclude your presentation, Mr. Wilk?

7 MR. WILK: It concluded the testimony. I
8 certainly have a closing argument I would like to make.

9 JUDGE LAMBERT: Okay. So if that concludes the
10 presentation at this time, and then if you make a closing
11 argument later, then we could move onto the questions of
12 the witness and Appellant, and then FTB can have their
13 presentation. Does that sound okay?

14 MR. WILK: Yes.

15 JUDGE LAMBERT: Okay. Thanks. So thank you for
16 your presentation for the testimony, Mr. McDonnell and
17 Mr. Wilk.

18 And, Ms. Pinarbasi, can you please, when you're
19 ready, you can proceed with not your presentation but any
20 questions of the witness first.

21 MS. PINARBASI: Thank you, Judge. This is Alisa
22 Pinarbasi, and I do not have any questions for the
23 witness.

24 JUDGE LAMBERT: Okay. Thank you.

25 And I'll turn to my panel first to ask if they

1 have any questions for the witness or Mr. Wilk.

2 Judge Aldrich, did you have any questions?

3 JUDGE LAMBERT: Hi. This is Judge Aldrich. I
4 just had a couple of questions, and I'll let Appellants'
5 representatives decide who answers them.

6 But so the example of the corrected Form 1099 was
7 brought up. Was that something that Appellants
8 experienced during the 2020 tax year it received a
9 corrected 1099?

10 MR. MCDONNELL: I would -- I don't know if the
11 Registers specifically received one, but many of my
12 clients did. I think it was brought up as an example of
13 the amount of time that was warranted to do my job.

14 JUDGE ALDRICH: Understood. And then so -- just
15 so I have the timing clear. There was a draft 2020
16 California resident income tax return prepared prior to
17 the extension, the May 17th extension, something like
18 that?

19 MR. MCDONNELL: Correct.

20 JUDGE ALDRICH: Okay. So at that time there was
21 sufficient information to be able to calculate it. Had it
22 been done correctly?

23 MR. MCDONNELL: Yes.

24 JUDGE ALDRICH: Okay. And then with respect to
25 the communication, it sounded like -- and maybe I

1 misunderstood that there wasn't really a whole lot of
2 further communication between you and the Appellants
3 between the draft copy and the conversation where you
4 informed them that it was late?

5 MR. MCDONNELL: Correct. That would be correct.

6 JUDGE ALDRICH: Okay. All right. Those are the
7 questions that I had. I'm going to refer it back to
8 Judge Lambert. Thank you.

9 JUDGE LAMBERT: Thank you, Judge Aldrich.

10 And now I'm going to turn to Judge Lam. And
11 Judge Lam, do you have any questions?

12 JUDGE LAM: Hi. This is Judge Lam speaking. I
13 don't have any questions. Thank you, Appellant, for your
14 presentation.

15 JUDGE LAMBERT: This is Judge Lambert, and I have
16 a couple of questions I think that I wanted to ask.
17 Mr. McDonnell, I was wondering -- I believe you're a CPA
18 in Massachusetts, and you stated that you've been doing
19 the return for California for about five years. And I'm
20 just, you know, looking at reasonable cause, I'm just
21 wondering if your competency or experience in California
22 tax law, do you have a lot of experience in that? And if
23 you -- do you have other clients' returns you've worked on
24 using California law?

25 MR. MCDONNELL: I do have other clients in

1 California. But admittedly nowhere the amount that I have
2 in Massachusetts. And I have a number of clients in a
3 number of states that typically originate in Massachusetts
4 and then have relocated for one reason or another and have
5 decided to stay with me as their accountant because we
6 developed a relationship over the years.

7 But if you were to ask me if I were as competent
8 in California law as I am with Massachusetts, absolutely
9 not. But I think I'm -- 45 years of experience, I think
10 I'm pretty good. But do we make mistakes? Yes.

11 JUDGE LAMBERT: Okay. Thanks. I was wondering
12 also, Mr. McDonnell, if there was something on the return
13 is, you know, the cause that -- the tax that was
14 unexpected, was it something that couldn't be estimated,
15 or was it just that it couldn't be -- it wasn't examined
16 until later on? And it was where you realized the mistake
17 later, but it's not something that was necessarily related
18 to something that could have been estimated and submitted,
19 figured out somehow? It was just a mistake that wasn't
20 realized until later?

21 MR. MCDONNELL: Yeah. There were two mistakes,
22 and one was a mistake of how my staff person handled
23 restricted stock. Mr. Register was a corporate executive
24 and had received restricted stock. And typically with
25 restricted stock most clients sell that restricted stock

1 immediately. And so their income is typically in their
2 W2. And then there's a corresponding sale of the stock
3 that they just received. So there's typically no gain on
4 the sale of that restricted stock.

5 However, in this instance there were some
6 shares -- a significant amount of shares that Mr. Register
7 had received in prior years that had increased in value
8 from the prior year to 2020 and, therefore, was resulting
9 in a significant capital gain. And my staff preparer
10 didn't realize the difference between the fact that these
11 restricted stocks were shares that were received in a
12 prior year that had the value that where they -- the value
13 of what they were when they were issued in a prior year,
14 versus the value this year when the current restricted
15 stock was. So he had a mixed bag, and my staff preparer
16 just didn't understand it. And so that was one error.

17 The second error was that with respect to the
18 expensing of fixed assets with the federal Section 179
19 allowing a million dollars. I think that year it was at
20 \$1 million and \$25,000 for election to expense fix asset
21 acquisitions in California, not following federal law with
22 respect to that. And that's something that I did miss.

23 JUDGE LAMBERT: Thanks, Mr. McDonnell. Is that
24 California adjustment that I see on the return that you're
25 referring to? That's the fed and state difference that

1 wasn't realized earlier?

2 MR. MCDONNELL: Correct. That was the big
3 adjustment between depreciation. So it was Section 179
4 expense deduction on the federal and a base -- a normal
5 depreciation deduction spread over seven years under the
6 California return.

7 JUDGE LAMBERT: Okay. And the restricted stock
8 issue, that's the difference between the wages and the
9 AGI?

10 MR. MCDONNELL: No. No. The restricted stock
11 was the same for federal and state. There was no
12 difference on the federal and state. Okay. But there was
13 a mixed bag of restricted stock that the taxpayer had in
14 2020. Some of it was restricted stock that vested in 2020
15 for which was reported on his W- 2 that he subsequently
16 sold and therefore, there was no gain on that. Okay.

17 So in other words, if you receive restricted
18 stock at its value today of \$20, your W-2 income reflects
19 \$20 of income. If you then sell it that day and sell it
20 for \$20, your tax basis is \$20, which is equal to what you
21 paid for the income recognized. And the income recognized
22 is obviously \$20. That's your basis. So for federal and
23 California rules, there's no gain on there.

24 It's obviously a reportable transaction because
25 some stock was sold, but it results in no gain. On the

1 other hand, if he received stock -- restricted stock,
2 let's say, in 2018, in my same example, that stock might
3 have been worth, let's say, \$15 when he received it. That
4 \$15 was reported in his W-2 in 2018, and he paid tax on
5 that \$15.

6 Subsequently, in 2020 when he would sell that
7 stock for \$20, okay, now we do have a capital gain. And
8 that capital gain is measured, again, by proceeds of \$20
9 versus his tax bases, which is \$15. Which, again, is
10 equal to the amount paid which was zero. And the income
11 they recognize, which back in 2018 was \$15. Okay. And
12 that's what my staff person missed.

13 JUDGE LAMBERT: Okay. Thanks for further
14 clarifying. That's is really helpful. And I just had, I
15 think, one more question just to -- I think you talked
16 about and I think Judge Aldrich asked about it. But in
17 terms of the communication, did they -- did you contact
18 them before the filing date or after, and let them know
19 you weren't going to file? Or was it -- when was the
20 date?

21 MR. MCDONNELL: It was after the filing date,
22 after the extended due date.

23 JUDGE LAMBERT: And did they -- did they contact
24 you on the filing date or before? Or was there any
25 communication where they were wondering when the return

1 was going to be filed, or did you let them know earlier?

2 MR. MCDONNELL: They didn't contact me, and I
3 didn't contact them. Because, again, as I stated, I
4 didn't think it was going to be an issue because I didn't
5 expect any tax to be due. And so with no tax due, we'd
6 have no interest, no penalties. We would get the returns
7 filed within a short period after the October 15th due
8 date -- extended due date.

9 And, again, there was no issues. I would explain
10 to them the return was technically late but again, because
11 there's no tax due, there would be no interest or
12 penalties. All that changed when I reviewed the return
13 subsequent to October 15th. But, again, within a
14 relatively short period of time we did get it finished and
15 filed and tax paid, approximately 2 to 3 weeks.

16 JUDGE LAMBERT: Thanks. And I guess I have one
17 more question. Have they -- have your clients owed tax
18 previously? Or would there be a situation where you
19 wouldn't need to feel compelled to file a return because
20 there would be no tax due after the extended due date? So
21 is it something that would be part of some sort of routine
22 in the past?

23 MR. MCDONNELL: There was -- with respect to the
24 Registers, their return was somewhat like a yo-yo in that
25 it went up and down depended on what kind of year he had

1 in the company, whether or not he vested in stock and
2 whether or not what the stock price was at the time.

3 So his return went up and down in value in terms
4 of tax liability, in terms of income. And that's why I
5 did the projections back in November and December. So I
6 have a number of clients like that where, you know,
7 they're not predictable. I also have a number of clients
8 where, you know, the returns can be the same every year
9 with slightly different numbers. With these particular
10 clients, I like to do a projection in November and
11 December for two reasons.

12 One, we want to know -- we want to know what the
13 tax liability is going to be, if there is any. And if
14 there is any, then should we pay it? Do we need to pay
15 some ahead of time, or can we wait until April 15th to
16 make a payment? That's one reason. Okay.

17 And the second reason, frankly, is that, you
18 know, for a CPA -- you folks are judges and you prepared
19 briefs in your previous jobs, I'm sure. Well, I'm a CPA
20 and all my briefs are due on the same day. So they're all
21 due on April 15th. And so when I get to April 15th,
22 there's a lot of stress. And I get a return like the
23 Registers with a \$5 million of AGI. And I've also got,
24 you know, a hundred of other clients that we're worried
25 about.

And if I see a projection that I had done in November and December when I was obviously a little less stressed, and that projection lends credence to the tax return that I'm getting from my staff person and they're similar, that gives me a lot of confidence that I feel comfortable with filing that extension.

JUDGE LAMBERT: Thanks. So in this case you sent them a projection earlier stating that they would owe no tax -- more tax?

MR. MCDONNELL: Right. November and December of the year before the -- you know, before the year even ended. Yeah.

JUDGE LAMBERT: Okay. Thank you very much for answering those questions.

Now, I'd like to move on to FTB's presentation.

Ms. Pinarbasi, you can proceed, and you'll have 15 minutes. Thanks.

MS. PINARBASI: Thank you.

PRESENTATION

MS. PINARBASI: Good afternoon. My name is Alisa Pinarbasi, and I, along with Maria Brosterhous, represent the Franchise Tax Board.

At issue in this appeal is whether Appellants have established reasonable cause to abate the late filing

1 penalty imposed for the 2020 tax year. Appellants have
2 put forward many arguments to demonstrate reasonable cause
3 for abatement of this penalty. Most prominently is the
4 argument that Appellants relied on their tax preparer, Mr.
5 McDonnell, to timely file their taxes.

6 While FTB sympathizes with the strains
7 Mr. McDonnell experienced in his practice while preparing
8 returns for the 2020 tax year, it is important to remember
9 that the reasonable cause analysis focuses on the
10 Appellants' actions. Your office has constantly held that
11 taxpayers have a nondelegable obligation to ensure the
12 returns are timely filed. This standard continues to be
13 upheld because, as explained in your office of
14 precedential opinion, Appeal of Fischer, congress assigned
15 to the taxpayer the duty to file timely, and reliance on
16 an agent is not justified when the agent does nothing the
17 taxpayer could not do themselves.

18 Appellants are not obligated to use --

19 JUDGE LAMBERT: Ms. Pinarbasi, can you please
20 slow down for the Stenographer. I think it would be
21 easier for her to transcribe, if you slow down a little.

22 MS. PINARBASI: Apologies.

23 Appellants are not obligated to use tax
24 preparation services. Therefore, at the very least, to
25 establish reasonable cause, Appellants must demonstrate

1 more than merely delegating the timely filing of the
2 return, such as personally verifying their return was
3 successfully submitted. There's no indication that
4 Appellants attempted to verify this or took any corrective
5 action when the due date for the return had passed.

6 In fact, Mr. McDonnell stated Appellants did not
7 know their return had not been timely filed until he
8 notified them several weeks after it was due. Further,
9 Appellants have not established any other basis for
10 reasonable cause. Mr. McDonnell has not provided
11 substantiation for his claims that certain necessary
12 documents related specifically to Appellants was received
13 late, or that receiving this information late directly
14 affected his ability to timely file Appellants' return.

15 Mr. McDonnell instead states that he prioritized
16 other clients' returns because his projections showed
17 Appellants had no tax due and, therefore, would not be
18 subject to a penalty if their return was filed late.
19 Mr. McDonnell knew of Appellants' filing obligation and
20 still chose to wait and file. As stated in your office's
21 precedential opinion, Appeal of Xie, X-i-e, a belief that
22 no tax will be due constitutes a gamble and not reasonable
23 cause sufficient to abate a penalty.

24 Appellants also argue FTB should institute a
25 similar procedure to the IRS' various available methods

1 for abatement. While the California legislature has
2 instituted a first-time abatement similar to the IRS',
3 it's only available for tax years beginning January 1st,
4 2022, and cannot apply to Appellants.

5 Appellants also argue that IRS Notice 2022-36
6 creates grounds for the FTB to abate the penalty in this
7 case. This IRS notice abated certain penalties for the
8 2019 and 2020 tax years. Among other things, it cited to
9 problems relating to the Covid-19 pandemic for this
10 abatement. FTB understands that the pandemic created
11 difficulty in timely meeting filing and payment
12 obligation. Therefore, it conforms to the IRS' extended
13 deadline for the 2020 filing and payment dates to
14 May 17th, 2021.

15 Notably, the IRS notice is not a -- it is not an
16 extension of a deadline. It is just merely an abatement
17 for penalties, and FTB only has authority to abate
18 penalties for reasonable cause. Because the IRS's notice
19 does not state the abatement of penalties is due to a
20 finding of reasonable cause, FTB does not have authority
21 to abate the penalty in this case. Therefore, on the
22 facts and evidence in the record, FTB would respectfully
23 request that you sustain its position.

24 I'm happy to address any questions the panel may
25 have.

1 JUDGE LAMBERT: Thank you, Ms. Pinarbasi.

2 I'm going to turn to my panel and ask if they
3 have any questions.

4 So, Judge Aldrich, did you have any questions?

5 JUDGE ALDRICH: This is Judge Aldrich. No
6 further questions. Thank you.

7 JUDGE LAMBERT: And, Judge Lam, did you have any
8 questions?

9 JUDGE LAM: Yeah. This is Judge Lam speaking. I
10 just wanted to clarify. FTB just cited the case for
11 Appeal of Xie, X-i-e?

12 MS. PINARBASI: That's correct.

13 JUDGE LAM: Thank you. And would you please
14 provide the citation as well.

15 MS. PINARBASI: Of course. That is
16 2018-OTA-076P.

17 JUDGE LAM: Thank you. This is Judge Lam
18 speaking. I don't have any questions.

19 JUDGE LAMBERT: This is Judge Lambert. Thanks,
20 Judge Lam.

21 And I was wondering, Ms. Pinarbasi, in this case
22 there was no late filing penalty. Do you know maybe why
23 there was not one?

24 MS. PINARBASI: I believe the reason for that is
25 because we only enforce either the late filing penalty or

1 the late payment penalty and not both.

2 JUDGE LAMBERT: Okay. Thank you. And I was just
3 wondering. Mr. McDonnell is going through various things
4 on the return that, you know, he's stating caused these
5 issues. And we don't have the return. We just have the
6 first five pages but, you know, have you reviewed it so
7 that you can confirm that, you know, what Mr. McDonnell is
8 pointing to were things that were reported on the return?

9 MS. PINARBASI: I have not confirmed that
10 specifically because I am only evaluating whether the
11 Appellants have established reasonable cause. And I
12 looked up the Appellants' actions and determined that they
13 did not establish reasonable cause or the late filing and
14 deemed that sufficient.

15 JUDGE LAMBERT: Okay. And also you mentioned an
16 IRS notice that could abate. Is that the same one that
17 on -- is that the Covid notice or what notice was that
18 again? Could you provide what it was?

19 MS. PINARBASI: Yes. That is IRS Notice 2022-36.
20 And that notice specifically stated that the IRS would be
21 abating certain penalties, including, I believe, the late
22 filing penalty for the 2019 and 2020 tax years and that it
23 would not require any action on Appellants' -- or excuse
24 me -- on taxpayers' behalf. They would just be
25 automatically abating those penalties.

1 JUDGE LAMBERT: Okay. And FTB doesn't follow
2 that notice?

3 MS. PINARBASI: FTB does not have authority to
4 follow that notice.

5 JUDGE LAMBERT: Okay. Thanks, Ms. Pinarbasi.

6 At this time we can move on to Mr. Wilk and
7 Mr. McDonnell. You can have your closing remarks. We
8 agreed previously to five minutes. So please continue
9 when you're ready.

10 MR. WILK: Thank you, Your Honor. And thank you
11 to all three of you Judges. We really appreciate your
12 time and attention. And I may have made a mistake by not
13 doing my arguments as part of the presentation. So I hope
14 the panel will indulge me if I slightly exceed the five
15 minutes for closing arguments.

16 JUDGE LAMBERT: Mr. Wilk, I think you didn't use
17 some of your time for your arguments. And if you
18 misunderstood that, we could just use the time that you
19 didn't use during your presentation. Just add it to your
20 closing. I believe you had about like 10 minutes or so or
21 something like that. So you could have extra time and we
22 can give you 15 minutes if you want to include that at
23 this point.

24 MR. WILK: I respectfully accept that offer or
25 proposal. Other than I will work assiduously to complete

1 this within five to seven minutes. So thank you.

2

3 CLOSING STATEMENT

4 MR. WILK: The Appellants, the taxpayers, Mr. and
5 Mrs. Register respectfully submit that reasonable cause
6 does exists for their failure to timely file their 2020
7 income tax returns. California and Revenue & Taxation
8 Code Section 19131 provides for relief from the penalty,
9 if the IRS determines that the penalty does not apply
10 because the failure to file on/or before the due date was
11 due to reasonable cause and not due to willful neglect of
12 the taxpayer.

13 Where the Franchise Tax Board's counsel stated
14 that the Franchise Tax Board does not have authority to
15 follow the IRS' Notice 2022-36, taxpayers respectfully
16 submit that that's not correct as a matter of California
17 law pursuant to Section 19131. Here, the IRS' Notice of
18 2022-36 was based -- the abatement by the IRS of any late
19 filing or late payment penalties for the 2020 tax returns
20 was based upon their determination that, in fact,
21 reasonable cause was -- did exist for all taxpayers and
22 tax preparers because of the Covid-19 pandemic.

23 It isn't just an extension of time to file or
24 pay. It was a determination by the IRS that there were
25 extraordinary pressure, circumstances, and burdens placed

1 upon both taxpayers and the tax preparers during the Covid
2 pandemic. Particularly note that this was during the
3 first year of the pandemic.

4 I misspoke. It was in 2021 when Mr. McDonnell
5 was in the process of preparing, but it was dealing with
6 the 2020 returns. But the fact is the IRS in that notice
7 did enunciate the reasonable cause for the delay of both
8 payment and filing of tax returns, and for that reason
9 abated any penalties. And under 19131 of the California
10 Revenue & Taxation Code, the Franchise Tax Board should
11 have followed suit in that determination of reasonable
12 cause.

13 Even if this body does not find that IRS Notice
14 2022-36 expressly finds that the pandemic and the burdens
15 placed on preparers during the pandemic constitute
16 reasonable cause or that such IRS finding is not binding
17 on California, Appellants urge this body to hold that the
18 pandemic and burdens placed on the preparer by the
19 pandemic, by Congress, by the State of California's
20 legislature, by the IRS and the Franchise Tax Board does
21 constitute reasonable cause.

22 Appellants further ask this body to find the
23 facts and circumstances testified to by Appellants' CPA,
24 Timothy McDonnell, established reasonable cause.
25 Appellants further submit that the evidence demonstrates

1 that they, the taxpayers, did not themselves fail to file
2 their tax returns timely, nor were they guilty of willful
3 neglect.

4 They had turned to their CPA who had prepared
5 their returns for many years to file their return. They
6 had been notified that no tax was due. There was nothing
7 extraordinary for them to do, or to put them on notice
8 that their tax returns were not filed. And, in fact, if
9 they had inquired a day or two or a week before the tax
10 extended due date of October 15th and had, in fact,
11 learned that the returns had not been filed, Your Honors,
12 could obviously discern from these complicated tax returns
13 there is nothing that these taxpayers could have done.

14 Counsel for the Franchise Tax Board indicated
15 that the taxpayers -- that there's no relief where the
16 taxpayers can do for themselves. There is no chance in
17 the world these taxpayers could have possibly prepared
18 themselves or under the circumstances in the pandemic
19 found another CPA or enrolled agent to prepare these very
20 complicated tax returns dealing with complicated issues,
21 such as the difference between California and federal law
22 on Section 179, expenses, and how to report and account
23 for the sale of restricted stock.

24 This was not a simple tax return where the
25 taxpayers could have simply put down off of their W-2 what

1 income they earned and file the return and showed how much
2 income tax was withheld. These were complicated returns,
3 and it isn't something that they could have done for
4 themselves.

5 Moreover, Appellants respectfully ask this body
6 to consider the purpose of the penalty, and the purpose of
7 the penalty is to encourage taxpayers to timely file their
8 tax returns. Here, these taxpayers, Appellants, have a
9 demonstrated history of timely filing their tax returns.
10 They have a history of employing a competent CPA to do so.
11 Here, taxpayers do not warrant a penalty to encourage them
12 to timely file their tax returns when they have
13 demonstrated for years doing so.

14 This was an event beyond their control. It was
15 due to the circumstances of the pandemic and the burdens
16 placed upon their CPA and the decision and the judgment of
17 their CPA, not themselves. The purpose of the penalty
18 would not be further by imposing the penalty in this
19 instance than by not abating the penalty. Without
20 failure, this CPA has correctly and timely filed the
21 Appellants' tax returns with the cooperation and help and
22 at the encouragement of the taxpayers without an audit, or
23 error, or prior penalty.

24 And although counsel for the Franchise Tax Board
25 states that the first-time abatement was not adopted by

1 California for 2020 or 2021 returns and only first adopted
2 in 2022, the IRS manual for the determination of
3 reasonable cause, which is not binding on the Franchise
4 Tax Board but which is precedential and instructive, the
5 IRS manual does encourage the IRS to take into
6 consideration the history and timely filing of a taxpayer.

7 And in this instance, the first-time abatement
8 has been adopted by California for 2020, it should have
9 been adopted in 2020. But even though it was not, and
10 even though it is not binding, it is some consideration
11 for reasonable cause and whether these taxpayers engaged
12 in willful failure to file their returns. They did not.
13 And that is the standard here for the penalty is, did the
14 taxpayers engage in a willful failure to file their tax
15 returns.

16 And we respectfully submit to, Your Honors, that
17 as the facts have been testified to here and provided to
18 this body, there can be no question that these taxpayers
19 acted willfully -- or that their returns were filed -- not
20 timely filed willfully.

21 JUDGE LAMBERT: Mr. Wilk, does that conclude your
22 presentation?

23 MR. WILK: I had just two more comments. May I?

24 JUDGE LAMBERT: Of course.

25 MR. WILK: Thank you.

1 Reasonable cause is established under California
2 law, if the failure to file occurred despite the exercise
3 of ordinary business care and prudence. These Appellants
4 exercised ordinary business care and prudence throughout
5 this process and based on the facts submitted to this
6 body.

7 Moreover, reasonable cause is established if the
8 cause would prompt an ordinary person to have so acted
9 under similar circumstances. Here, the facts and evidence
10 presented today prove that ordinary persons would have so
11 acted under similar circumstances of this extraordinary
12 pandemic and the emergency orders of the governors of
13 California and Massachusetts and the President of the
14 United States as demonstrated by the IRS Notice 2022-36.
15 And any other taxpayer of reasonable prudence would have
16 acted the same way that these taxpayers did in this
17 specific instance.

18 Final argument, the recent Franchise Tax Board
19 action to follow the IRS grant of an extension to most
20 taxpayers to file their 2022 tax returns by October of
21 2023 due to the, quote, "Emergency," end quote, caused by
22 the 2022, 2023 winter storms further demonstrates and
23 supports why California should follow the IRS
24 determination that the emergency created by the Covid-19
25 pandemic justifies taxpayers filing their 2020 tax returns

1 late.

2 The Covid pandemic and the emergency orders of
3 the United States President and governors of virtually
4 every state in this union demonstrates that the emergency
5 and the burdens placed on taxpayers and tax preparers as
6 far greater than the winter storms in California in 2022
7 and 2023, and for most counties.

8 It is -- it would be a shame that taxpayers are
9 penalized for late filing -- or filing their taxes and
10 paying their taxes in -- by October of 2023 due to the
11 winter storms. But the penalty imposed for these
12 taxpayers for their failure to file their tax return for
13 2020 was not due to reasonable cause.

14 Based on the foregoing, the taxpayers believe the
15 factors weigh towards abating the \$70,875 penalty failure
16 to file penalty and respectfully request that the Office
17 of Tax Appeals reverse the decision of the Franchise Tax
18 Board and authorize the refund of said amount to the
19 taxpayers.

20 Thank you very much.

21 JUDGE LAMBERT: This is Judge Lambert. Thank
22 you, Mr. Wilk. And since you gave some arguments there, I
23 just want to double check with FTB.

24 Ms. Pinarbasi, do you have anything that you
25 wanted to briefly add or address.

1 MS. PINARBASI: This Alisa Pinarbasi. I don't
2 have anything else I would like to address. Thank you.

3 JUDGE LAMBERT: Okay. Thanks.

4 So at this time, I'll just turn to the panel and
5 see if there is any final questions.

6 Judge Aldrich did you have any final questions?

7 JUDGE ALDRICH: Hi. This the Judge Aldrich. I
8 have one final question and the question is for
9 Mr. McDonnell. Between the draft copy that was prepared
10 and October 5th, 2021, did your scope of authority include
11 signing for the Appellants?

12 MR. MCDONNELL: No. I would sign the tax return
13 as the preparer but not as the taxpayer. No.

14 JUDGE ALDRICH: Okay. That's it. Thank you.

15 JUDGE LAMBERT: This is Judge Lambert. So
16 Judge Lam, I was wondering if you had any final questions?

17 JUDGE LAM: This is Judge Lam. I don't have any
18 final questions. Thank you.

19 JUDGE LAMBERT: Thanks.

20 This is Judge Lambert again, and I just had one
21 final question. I wanted to ask Mr. McDonnell maybe just
22 to clarify. You were saying before that the Appellants
23 contacted, I think, right after the due date. And then
24 FTB in their presentation was mentioning it was several
25 weeks. I see it says, several weeks before there was any

1 communication, in the briefs. So I'm just trying to
2 clarify the facts as to when the taxpayers or Appellants
3 were first contacted after the due date or before in terms
4 of what was going to happen with the filing?

5 MR. MCDONNELL: It would have been shortly after
6 October 15th but clearly by November 1st. November 1st is
7 the date that I finalized the tax return and sent it to
8 the Registers, but I, obviously, had discussed with them
9 before then. Probably closer to the November 1st date
10 than the October 15th date. Clearly after October 15th
11 but before November 1st, which was the date on the tax
12 return that I mailed to them. And November 4th was the
13 date that we actually electronically filed the return.

14 JUDGE LAMBERT: Okay. So it was just two weeks
15 later that it was filed?

16 MR. MCDONNELL: Two to three weeks. Two weeks
17 the discussion with the taxpayer, and within three weeks
18 the return was filed.

19 JUDGE LAMBERT: Okay. Okay. Thank you,
20 Mr. McDonnell.

21 So if there's nothing further, I'm going to
22 conclude the hearing. And I want to thank both parties
23 for attending today, and we will issue a written opinion
24 within 100 days.

25 Thank you. The record is now closed. And that

1 concludes our hearings for today. So thanks again.

2 (Proceedings adjourned at 4:04 p.m.)

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