

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,           )  
   )  
S & I CONSTRUCTION, INC.,                 ) OTA NO. 18093713  
   )  
                    APPELLANT.                 )  
   )  
   )

## TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Tuesday, August 8, 2023

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Proceedings, taken at  
12900 Park Plaza Dr., Suite 300, Cerritos,  
California, 91401, commencing at 9:37 a.m.  
and concluding at 10:25 a.m. on Tuesday,  
August 8, 2023, reported by Ernalyn M. Alonzo,  
Hearing Reporter, in and for the State of  
California.

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APPEARANCES:

Panel Lead: ALJ RICHARD TAY

Panel Members: ALJ OVSEP AKOPCHIKYAN  
ALJ ASAF KLETTER

For the Appellant: EREZ SOLOMON

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD  
D'ARCY DEWEY  
ADAM SUSZ

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-38 were received at page 6.)  
(Department's Exhibits A-BB were received at page 6.)

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1 Cerritos, California; Tuesday, August 8, 2023

2 9:37 a.m.

3  
4 JUDGE TAY: Okay. We are opening the record then  
5 in the Appeal of S & I Construction, Inc., before the  
6 Office of Tax Appeals, Case Number 18093713. This hearing  
7 is being convened today in Cerritos, California, on  
8 August 8th, 2023.

9 Today's case is being heard and decided equally  
10 by a panel of three judges. My name is Judge Tay, and  
11 I'll be acting as the lead judge for the purposes of  
12 conducting this hearing. Also on the panel with me today  
13 are Judges Ovsep Akopchikyan and Judge Asaf Kletter.

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

16 MR. IBGVY: Jonathan Ibgvy.

17 JUDGE TAY: Okay.

18 MR. SOLOMON: Erez Solomon. I'm the  
19 representative for Jonathan and S & I Construction.

20 JUDGE TAY: Thank you, Mr. Solomon.

21 And Franchise Tax Board.

22 MS. DEWEY: D'Arcy Dewey for Franchise Tax Board.

23 MR. SUSZ: Adam Susz for Franchise Tax Board.

24 JUDGE TAY: Okay. The issue we'll discuss today  
25 is whether Appellant has shown Franchise Tax Board erred

1 in its denial of business expense deductions from  
2 subcontractor expenses for the 2010 tax year.

3 Now, prior to this hearing we received exhibits  
4 submitted by both parties and it contains -- so those  
5 exhibits are 1 through 38 for Appellant and Exhibits A  
6 through BB from Franchise Tax Board.

7 There were no objections to admitting the  
8 exhibits into evidence; is that right?

9 MR. SOLOMON: Correct.

10 JUDGE TAY: And Franchise Tax Board?

11 MS. DEWEY: Yes, that's correct.

12 JUDGE TAY: So these exhibits will now be  
13 admitted into the evidence.

14 (Appellant's Exhibits 1-38 were received  
15 in evidence by the Administrative Law Judge.)

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

18 JUDGE TAY: We're going to start with  
19 Appellant --

20 MR. SOLOMON: I have -- I have one question.

21 JUDGE TAY: Yes.

22 MR. SOLOMON: I have mailed the Respondent a  
23 letter with two boxes on May 19th, 2021, with all the  
24 documents. I just wanted to make sure that you have it,  
25 you received it.

1 I can show you what -- that was two years ago.  
2 That was this letter with all of the samples after the --  
3 MS. DEWEY: IRS audit?  
4 MR. SOLOMON: No, no.  
5 JUDGE TAY: Was this submitted on appeal,  
6 Mr. Solomon?  
7 MR. SOLOMON: Yes.  
8 MS. DEWEY: These ones?  
9 MR. SOLOMON: Yes. You have it?  
10 MS. DEWEY: Yes.  
11 MR. SOLOMON: Okay.  
12 JUDGE TAY: Okay. And just so our Panel knows  
13 what -- it was submitted -- was it February 18th, 2021?  
14 MR. SOLOMON: May 19, 2021 --  
15 JUDGE TAY: May 19, 2021.  
16 MR. SOLOMON: -- after the.  
17 JUDGE TAY: Oh, yeah. Okay. We do have it here.  
18 MR. SOLOMON: That's the OTA request to provide  
19 documentation. I explained that it's over 25 boxes. So  
20 what I did is summarize the documentation for a sample  
21 every month, a few of them. So it will be easy and, if  
22 needed, I have all the rest of the documentation.  
23 JUDGE TAY: Okay. Thank you.  
24 So why don't we start off. I will swear in the  
25 witness.

1           So, sir, if you don't mind standing for me and  
2           raising your right hand.

3  
4                               J. IBGVY,  
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 TAY:   Okay.   Thank you.

10                   Appellant, you will have 20 minutes.   Please  
11           begin whenever you're ready.   Thank you.

12                   MR. SOLOMON:   I'm ready.

13  
14                               PRESENTATION

15                   MR. SOLOMON:   So this case is an example of an  
16           abuse of power by the FTB, and I will explain why.   I will  
17           just explain before that the OTA have recommended FTB to  
18           see if there's any way to settle the case.   No settlement,  
19           even though I have made several attempts to settle the  
20           case, they will not comply and did not want to settle the  
21           case.

22                   And the main -- when the FTB did their audit,  
23           they audited the whole items, all expenses.   I, to make  
24           this case simple, I reduced it to one question; whether we  
25           are allowed to get the 95 percent of the cost of goods



1 sold slash subcontractor expenses.

2 Now, is -- I will start by this. S & I  
3 Construction --and that's from the Respondent's  
4 briefing -- the Respondent's opening brief. That's page  
5 4, line 18 through 21, and that describes the nature of  
6 the business. So we'll be on the same page. S & I  
7 Construction is the middle company in the operation of  
8 construction services. S & I Construction is --

9 THE STENOGRAPHER: Mr. Solomon, may I ask you to  
10 please bring the mic closer to you, please?

11 MR. SOLOMON: Of course.

12 S & I Construction is in the nature of finding  
13 the right client, the right subcontractor, and providing  
14 the cash flow in order to complete the project. S & I  
15 received 5 percent commission from every project. It is  
16 the nature of the business to provide cash for contractors  
17 so they can finish the project. That's, again, page 4,  
18 line 18 through 21 of the Respondent's opening brief.

19 Also, on the responding operating brief, page 5,  
20 line 45, it says, "The auditor reviewed over 1,480 copies  
21 of invoice listings, allegedly, issued by subcontractors  
22 after excluding duplicates and invoices listing  
23 third-party, pays total \$12,860,449." The audit also  
24 reviewed over 2,000 invoices issued by the Appellant, by  
25 the Appellant to clients and corresponding canceled

1 checks.

2 Client's invoice typically itemized the cost of  
3 the project or job completed and the Appellant's 5 percent  
4 commission. The auditor compared the first quarter date  
5 sample of clients' checks and subcontractors' invoices.  
6 Found on the subcontractors' invoices generally reflect  
7 the 95 percent of client checks allocated to job cost,  
8 which only a minor difference of \$3,661. So out of this  
9 \$12 million the difference was \$3,000. The auditor  
10 determined that the subcontractor invoices provided were  
11 credible evidence of the Appellant's subcontractor  
12 expenditure. So that's basically from the Respondent's  
13 brief.

14 Again, on May 19 we mailed the FTB two boxes with  
15 samples of each month's invoices and original checks to  
16 verify the 95 percent expenses of the remaining months.  
17 To this point, we have never heard anything from the  
18 Respondent, from the FTB, in regard to whether they agree,  
19 whether they reviewed it, or whether they accept or wants  
20 additional documentation.

21 Now, what I want to say just now is that the FTB  
22 have audited the taxpayer for the year 2010. They  
23 reviewed the first four months and allowed -- and with  
24 those four months I have no issue. They allowed the  
25 95 percent, and I agree with this. For the remaining

1 date, did not allow anything because I believe -- again, I  
2 was not the representative at the time. But I believe  
3 that at the time of the audit they did not have the  
4 records ready.

5 So what the FTB did is disallow everything for  
6 the other eight months, allowing only the four months.  
7 And what I asked is that the FTB will make the same  
8 percentage because it's the same business, same in nature  
9 of the business and will allow us the same percentage of  
10 expenses, which is 95 percent taxes on us on remaining  
11 5 percent. And I explained that for those 5 percent to  
12 make it easy I will ask no other expenses, no office  
13 expenses, no other expenses at all except for what they  
14 already allowed so we can settle this easily.

15 The IRS has audited the taxpayer for the same  
16 year, the 2010. And the meeting was at the taxpayer's  
17 place of business and included all documents and over  
18 25 boxes of documents. Each box includes 800 pages. The  
19 IRS started the audit on October 8, 2011 and ended it on  
20 January 13, 2014, with no change. I have provided a copy.

21 Should I provide another copy of this or you  
22 don't need?

23 But this is part of the exhibits and does --  
24 that's basically what -- so we have enclosed the copy of  
25 the account transcript to verify that the net receipts,

1 according to the IRS, was \$29 million, similar to what the  
2 FTB found and agreed. Net taxable income was \$172,000.  
3 And the tax that was eventually paid and accepted by the  
4 IRS was \$50,000. That was for the IRS.

5 The OTA have requested on Question 2 that the FTB  
6 will contact the IRS and get a copy of the file, which  
7 they never did. So I have contacted the IRS, and I have  
8 provided, and that's part of the case and the evidence, a  
9 full copy of the IRS file. It's -- that was also part of  
10 the evidence, a copy of the file request and the IRS  
11 response and the full file showing the audit.

12 I want to add that the FTB made another audit for  
13 the taxpayer for the years 2015 and 2016 on the same  
14 issue, resulting by allowing the full cost of goods sold  
15 as we explained. In those years '15 and '16, the  
16 percentage was a little bit higher because they started  
17 charging higher commission, which was 7 percent instead of  
18 the 5 percent. But the FTB audit case, they did  
19 January 7, 2020, and I have enclosed it. And that was  
20 also part of the case and what we have submitted.

21 So both the IRS and the FTB audited the taxpayer,  
22 and the FTB basically in '15 and '16 found that this is  
23 the same business and allow us all the subcontractors'  
24 cost of goods sale/cost of goods sold in the amount of 93,  
25 which is in 2010 it was 95 percent. Appellant was audited

1 by the IRS for 2011, and the FTB followed the assessment.  
2 And this was also part of the case that we have filed --  
3 that we have presented.

4 There was a huge assessment that was later  
5 reversed by the IRS. Of course, the FTB never bothered to  
6 correct its own report. So I had to file an appeal  
7 protest and show them that the IRS reversed the 2011  
8 assessment and basically, finally, they reduced it. And  
9 instead of asking over \$500,000 with penalties and  
10 interest, it was over \$1 million, they charged \$3,000.  
11 And that was also part of the documentation I have  
12 provided, and it's in the case.

13 Now, the OTA have asked the Respondent three  
14 questions. One of them is to explain, based on the FTB's  
15 examination, does it appear that substantially all of the  
16 Appellant's gross receipts arose from client checks? And  
17 the second Question B for Question 3 was based on FTB's  
18 examination of client checks and invoices for January 1st  
19 until April 30, 2010 period, and the clients' invoices and  
20 checks and work papers referenced in Footnote 18 of the  
21 FTB opening brief, does it appear that the Appellant paid  
22 approximately 95 percent of the client check amounts to  
23 subcontractors?

24 And a Question C -- 3C, was, if reliable  
25 documentations is not available for the amounts of

1 subcontractor expenses, include from May 1st through  
2 December 2010, could the FTB sample -- could the FTB's  
3 samples of January 1st to April 30th period, which  
4 indicates that the Appellant pay subcontractor  
5 approximately 95 percent of the sum of the clients' checks  
6 be used to estimate that Appellant had subcontractor  
7 expenses, approximately 95 percent of the \$22 million. Of  
8 course, the FTB never agreed with those recommendation of  
9 those questions by the OTA.

10 And to summarize everything and I will make it  
11 short and I will finish in one or two minutes. What we  
12 ask is very simple. We ask for the expenses that we  
13 incurred, and the business was the same business from  
14 2010. It started in 2008 but never get into operation  
15 until 2010. 2010 was the first year of this business.  
16 It's boomed. They never realized -- and I will ask the  
17 taxpayer to explain the operation in 2010 and how they  
18 started the business.

19 They never kept good records and that's a fault,  
20 and that's why they had to go through these issues. But  
21 they had expenses, and it makes no sense that the same  
22 business had expenses in the first four months, and the  
23 other 8 months they had expenses. And in '11 he had  
24 expenses. And in '12, '13, '15 and '16 as the FTB itself  
25 audited the taxpayer, they had expenses. So what they

1 claim is that we had expenses in the first four months, no  
2 expenses in the other eight months. And that's why they  
3 want to base this huge assessment. Which for me, makes no  
4 sense and for me, it's -- I don't want to say too hard,  
5 but it's like an abuse of power.

6 Since the taxpayer never kept the record and he  
7 was not good but, again, this was the first year, and he  
8 will explain this in a minute. They want to charge us.  
9 Today it will be over \$1 million with penalties and  
10 interest over the profit that they had that year just  
11 because they decided that we did not keep good records.  
12 And again, we did reconstruct the documentation later, and  
13 we do have the 25 box of the receipts, which they never  
14 attempted to review. I did mail them samples, two boxes  
15 of samples for those eight months. And basically, that's  
16 all.

17 Lastly is both the IRS audited him for this year,  
18 an internal review. If you will read the case we  
19 submitted from the IRS, they started with fraud, with  
20 laundering money because of the huge amounts of money that  
21 was here and eventually the IRS closed this case in 2010  
22 with no change. No change. So usually from my  
23 experience -- I used to be a lawyer in damages -- when  
24 there is a dispute between two parties, they appoint a  
25 third expert to review the case and decide.

1           And in our case, the third-party expert, which is  
2           not connected to me or the FTB, is the IRS, and they  
3           review everything here. And they decided that there's no  
4           issue and no -- should be no change. And that's why I ask  
5           the OTA to allow us the 95 percent of subcontractor  
6           expenses for the remaining eight months, which they never  
7           did.

8           Now I will ask the taxpayer just to explain how  
9           they started this business, which he started this business  
10          with his father, and why in 2010 did not keep good  
11          records. Okay?

12          JUDGE TAY: Yes. Just as a matter of time, we do  
13          have about three minutes left of your presentation. So  
14          I'll give Mr. Ibgvy an opportunity to present his  
15          testimony, but I ask that you be mindful of the time.  
16          Thank you.

17          MR. IBGVY: Okay. I'll keep it brief.

18  
19                                   WITNESS TESTIMONY

20          MR. IBGVY: So for that year -- for that year, we  
21          just started, so we didn't really have a headquarters or  
22          an office, and we would go with our car from -- you know,  
23          in our car from office to office and assist those  
24          companies. And so business was booming to an unexpected  
25          rate and just never -- we weren't able to do the invoices



1 per se for that year, and so I fell behind in that -- in  
2 that regard. So that would explain why we had to recreate  
3 those invoices for that year retroactively.

4 MR. SOLOMON: Today?

5 MR. IBGVY: Today, though, there's an office and  
6 a full system in place, and we invoice every -- every  
7 transaction that occurs.

8 MR. SOLOMON: That's all?

9 MR. IBGVY: Yeah.

10 JUDGE TAY: Okay. Thank you for that testimony.

11 I'm just going to give Franchise Tax Board an  
12 opportunity to ask you any questions that they would like  
13 to ask. So I'm going to hand it over to Franchise Tax  
14 Board.

15 Do you have any questions for the witness?

16 MS. DEWEY: Yes. Good morning. This is D'Arcy  
17 Dewey with Franchise Tax Board. We have no questions.  
18 Thank you.

19 JUDGE TAY: Okay. Thank you. Ms. Dewey, if you  
20 don't mind just bringing your mic a little bit closer, we  
21 would appreciate that.

22 Okay. Appellant, does this conclude your  
23 presentation?

24 MR. SOLOMON: Yes.

25 JUDGE TAY: Okay. I'm going to turn to my

1 Panelists to see if they have any clarifying questions for  
2 you.

3 I'll turn first to Judge Kletter.

4 JUDGE KLETTER: This is Judge Kletter. I have no  
5 questions. Thank you.

6 JUDGE TAY: Thank you.

7 And Judge Akopchikyan?

8 JUDGE AKOPCHIKYAN: Yeah. I have a few  
9 questions. So I just want to understand a little bit more  
10 about the business. You indicated that you do funding as  
11 well.

12 MR. IBGVY: Yes.

13 JUDGE AKOPCHIKYAN: So are you a loan broker  
14 or -- I mean, tell me a little bit more about the  
15 business.

16 MR. IBGVY: No. What we do is we work with other  
17 construction companies, and when they have a high influx  
18 of jobs, they can't start them all at the time. They  
19 don't have the funding for that. So we charge a  
20 commission to fund those jobs for them, and they've been  
21 utilizing our services ever since.

22 JUDGE AKOPCHIKYAN: So if I'm a contractor, I  
23 take a job and I don't have the funds to do it, that's  
24 when I reach out to you?

25 MR. IBGVY: That's right. For example, you'd

1 start a job for \$10,000, let's say, and you don't have the  
2 \$5,000 to start the job, per se, and the client is paying  
3 you a down payment, usually it's about \$1,000. You would  
4 then come to my company, write me a check for the funds  
5 that you need. I deduct my commission, and then I fund  
6 the job for you and you can proceed to do the work, the  
7 contractor can. And as they get paid and the job  
8 progresses, they, you know --

9 JUDGE AKOPCHIKYAN: So you're not the one  
10 actually doing the work?

11 MR. IBGVY: No.

12 JUDGE AKOPCHIKYAN: Okay. So --

13 MR. IBGVY: No. I do, since I have a  
14 construction company, I do, obviously, jobs on my own.  
15 But with these other companies, no, I do not do the work.  
16 I simply fund the material and contractor expenses that  
17 they require.

18 JUDGE AKOPCHIKYAN: Okay. And in 2010 you said  
19 four months were allowed based on invoices. Eight months  
20 were disallowed based on lack of invoices. So you did  
21 create invoices for four months but stopped with  
22 invoicing?

23 MR. IBGVY: No.

24 JUDGE AKOPCHIKYAN: Why do we have invoices for  
25 four months and not invoices for eight months?

1 MR. IBGVY: We have the invoices.

2 MR. SOLOMON: Can I explain this?

3 MR. IBGVY: No. Go ahead.

4 JUDGE AKOPCHIKYAN: Either one. Yeah.

5 MR. SOLOMON: Thank you. So what happens is we  
6 have no invoices whatsoever. Once we got to the audit, we  
7 recreate the invoices. We started with the first four  
8 months. That's what we created. That's what the FTB  
9 reviewed. It took us much more time to continue with  
10 creating the other eight months, which we created later,  
11 few months after that. Unfortunately, the FTB reviewed  
12 only the four months I believe. Again, I was not part of  
13 this audit back then.

14 What I believe happened is that they reviewed the  
15 four months because we created only those four months at  
16 this period. We continue to create, recreate, or  
17 reconstruct the other eight months, but once the audit --  
18 or they finished the audit or the auditor decided to close  
19 the case, either way, we never finished. We did not  
20 finish recreating the invoices, or that they did not want  
21 to review the additional that we created. But we do have  
22 the additional eight months.

23 And as I explained on May 19th, I have 2011. I  
24 have mailed the FTB two boxes with samples of those  
25 invoices. I have 25 boxes in my office. We asked them

1       several times to come review it but, apparently, it was  
2       too late for them.

3               JUDGE AKOPCHIKYAN:   Okay.   So you also indicated  
4       you have a summary of those 25 boxes.   Is that -- has that  
5       already been submitted and part of the record?   What  
6       exhibit number is that?

7               MR. SOLOMON:   This is the letter that we sent.   I  
8       talked to Judge Tay in the beginning of this hearing.   And  
9       that was a letter we mailed the FTB on May 19th, 2021.   I  
10      don't remember the --

11              JUDGE AKOPCHIKYAN:   Okay.

12              MR. SOLOMON:   But it's here.

13              JUDGE AKOPCHIKYAN:   But you did submit --

14              MR. SOLOMON:   Yeah.   Yeah.   We did submit it.

15              JUDGE AKOPCHIKYAN:   The file almost 2,000 pages.  
16      So I understand.

17              MR. SOLOMON:   Let me show you, and show you that  
18      it's correct.

19              JUDGE TAY:   We have the letter May 19, 2021.   We  
20      have that.   Yeah.   Yeah.

21              MR. SOLOMON:   I just want to show you.   This is  
22      the letter.   This is the list of all the invoices that we  
23      have provided.

24              JUDGE AKOPCHIKYAN:   Okay.   We have an electronic  
25      copy.

1           MR. SOLOMON: And attached to it there was --  
2           that's the checks and copies of everything that was in  
3           those two boxes. These were copies of those, these pages.

4           JUDGE TAY: Thank you, Mr. Solomon.

5           JUDGE AKOPCHIKYAN: Okay. I don't have any more  
6           questions at this time. Thank you.

7           MR. SOLOMON: Thank you.

8           JUDGE TAY: I just have one clarifying question.  
9           The recreated invoices, how are those recreated?

10          MR. SOLOMON: It was recreated -- so the  
11          recreated invoices were both for the four months that they  
12          allowed and the eight months that they disallowed. So how  
13          they were created? Basically, it was recreated based on  
14          the checks. We went to the client that we did business  
15          with and we got the invoices from them. And it was a copy  
16          of the check that we received, a copy of the payments that  
17          we gave them, and the invoice from the clients, and the  
18          invoice from us to the clients.

19          MR. IBGVY: Maybe recreated is an incorrect word.  
20          It would be retroactively made. Because the nature of the  
21          business is many micro-transactions. So it's hundreds of  
22          checks a week, which comes out to thousands over the year.  
23          So it took an amount of time to go in check per check and  
24          create an invoice for each one, which is the system I have  
25          in place now. And so I had to go back and do that.

And I don't know. It's 13 years ago, so I don't know if there was a time frame that couldn't submit the full 12 months that I had initially made or what, but I was able to do four months' worth and the rest subsequently.

MR. SOLOMON: But what I want to clarify is that the four months that they allowed are the same as the eight months. Both were not in place at the minute of the transaction. Both were reconstructed, recreated, or reissued once the audit started. So in our eyes there's no difference between those four months and the other four months. It was all the same matter of recreating and reconstructing them.

JUDGE TAY: Okay. I think I have another question, but I'm going to allow Franchise Tax Board their turn to give their presentation, and then we'll see if we have any questions after that. Okay.

I'm going to turn it over to Franchise Tax Board  
for their presentation.

You have ten minutes for your presentation.

MS. DEWEY: Yes.

JUDGE TAY: Please begin whenever you're ready.

MS. DEWEY: Thank you, Judge.

## PRESENTATION

1 MS. DEWEY: Good morning. My name is D'Arcy  
2 Dewey, counsel for Respondent Franchise Tax Board. I'm  
3 here with my co-counsel Adam Susz.

4 As we've already discussed, the soul issue  
5 remaining is whether Respondent erred in disallowing  
6 Appellant's claim to additional trade or business  
7 deductions for subcontractor expenses. Appellant has  
8 conceded all other issues on appeal.

9 S & I Construction, Inc., is a C corporation that  
10 operates a construction business. California generally  
11 conforms to IRC Section 162 which allows a deduction for  
12 ordinary and necessary business expenses. Appellant has  
13 the burden to show that it is entitled to the deductions.  
14 To prevail in this action, it must show with credible  
15 evidence that the expenses were actually paid or incurred.

16 Appellant has not met its burden. It did not  
17 produce accurate accounting records as it concedes. The  
18 general ledgers that it did provide could not be  
19 reconciled to receipts or invoices. So without accurate  
20 books, Respondent was forced to rely on source documents  
21 to estimate Appellant's revenue and expense. The auditor  
22 reviewed records from multiple bank accounts, copies of  
23 canceled revenue checks, invoices issued by Appellant to  
24 its clients, loose-leaf receipts, and invoices issued to  
25 Appellant by subcontractors, which I refer to



1 subcontractor invoices.

2           Based on the bank deposits, Respondent reduced  
3 Appellant's gross receipts, which Appellant is not  
4 contesting. Because Appellant paid most of its expenses  
5 in cash, Respondent could not verify whether Appellant  
6 paid the amounts billed by the subcontractor invoices.  
7 Nevertheless, Respondent allowed significant subcontractor  
8 expense deductions, over \$11 million.

9           Appellant argues that it had expenses equal to  
10 95 percent of its gross income because it had a practice  
11 of billing clients for cost plus 5 percent commission. It  
12 alleges that it has boxes of additional invoices to  
13 support this claim. Samples of these invoices were  
14 provided late in the audit after the auditor's preliminary  
15 decision and again in this appeal. Appellant did not meet  
16 its burden to prove that it had expense equal to  
17 95 percent of gross income.

18           The credible subcontractor invoices provided  
19 prior to auditor's preliminary decision did not equal  
20 95 percent of gross income. The client check revenue in  
21 our client check work paper equaled approximately 83  
22 percent of gross receipts as determined by Respondent.  
23 The invoice samples provided after the auditor's  
24 preliminary decision and on appeal lack credibility for a  
25 number of reasons. These late supplied invoices are not

1 contemporaneous records as the Appellant has conceded.

2 Appellant's sole shareholder also explained that  
3 they hired a team to recreate the QuickBooks accounts and  
4 use these accounts to request records from the  
5 subcontractors. The new invoices did not contain same  
6 logos as the old invoices and did not contain detailed  
7 itemizations. In addition, each invoice is bundled with a  
8 revenue check and a revenue invoice. Each of these  
9 documents in a bundle is for the exact same amount. So if  
10 they are accurate, Appellant made exactly the same profit  
11 from these transactions. For these reasons the invoices  
12 are not reliable.

13 I want to point out here also that while  
14 Appellant has claimed that we only allowed four months of  
15 subcontractor invoices, the subcontractor invoices that  
16 were deemed credible came from all 12 months of the year.  
17 They're not limited to a four-month sample. Appellant has  
18 argued that Respondent's 2011 protest determination and  
19 the 2015 and 2016 audit decision support its claim to  
20 additional expenses. However, Appellant is mistaken.  
21 Each taxable year must stand on its own merits and be  
22 considered separately.

23 The statutes pertaining to the determination of a  
24 taxable income have proceeded generally on the principal  
25 that there shall be a computation of gains and losses on

1 the bases of a distinct accounting for each taxable year.  
2 Respondent's 2011 protest determination was based on a  
3 federal adjustment to gross income and does not bear on  
4 this case.

5 Respondent's audit decision for 2015 and 2016  
6 adjusted Appellant's gross receipts, cost of goods sold,  
7 and expense deductions. The adjustments also do not bear  
8 the 2010 tax year because the records before the auditor  
9 in 2010 are different from the records before the auditor  
10 in 2015 and 2016. Appellant also raise that the IRS  
11 audited the 2010 return, which is the return in this  
12 appeal, with no change. However, Respondent and your  
13 Panel are not required to agree with an IRS decision, even  
14 when the determination results from a detailed audit.  
15 There's no evidence that this was a detailed audit.

16 The IRS audit work papers submitted by Appellant,  
17 the IRS transcript, and the business master file provide  
18 little information on the nature of the audit. Most of  
19 the audit work papers, in fact, are completely blank and  
20 not completed, not dated. There's no revenue agent report  
21 and no other explanation of the agent's finding.  
22 Therefore, we have little insight into why the audit was  
23 concluded.

24 In contrast, Respondent conducted a detailed and  
25 well documented audit and its assessment should not be put

1     aside based on the IRS action. On the OTA's request, the  
2     parties addressed what's known as the Cohen rule from  
3     Cohen v Commissioner. Under that case, if a precise  
4     amount of the deductions cannot be determined but a  
5     deductible expense has been incurred, the finder of fact  
6     may estimate the amount of the deduction. However, the  
7     estimate should weigh heavily against the taxpayer whose  
8     inexactitude is of the taxpayer's own making.

9             In this case, Respondent estimated Appellant's  
10    expenses based on credible invoices even though actual  
11    payment could not be verified. To warrant a different  
12    estimate, Appellant must be able to show that it actually  
13    spent or incurred the expenses in excess of those allowed  
14    by Respondent. As I've already discussed Appellant has  
15    failed to do this. So for these reasons Respondent  
16    respectfully requests that the OTA affirm it's assessment  
17    in this matter.

18            Thank you.

19            You know, actually, I'm so sorry. Judge, can  
20    I -- can I have a --

21            JUDGE TAY: Yes, you can.

22            MS. DEWEY: I wanted to address a couple of  
23    comments by the Appellant in their statement. The  
24    Appellant claimed that FTB only allowed 12 months of  
25    subcontractor expenses as I stated -- I'm sorry, four

1 months of subcontractor expenses. Those -- those invoices  
2 come from all 12 months. The Appellant also contended  
3 that we never reviewed the invoices submitted on appeal,  
4 the subcontractor invoices. We responded to that  
5 submission in our supplemental briefing.

6 And I think that would be it. Thank you very  
7 much.

8 JUDGE TAY: Thank you, Franchise Tax Board.

9 I'm going to turn to my Panelists to see if they  
10 have any questions for Franchise Tax Board.

11 Judge Kletter?

12 JUDGE KLETTER: This is Judge Kletter. I do not  
13 have any questions. Thank you.

14 JUDGE TAY: Thank you.

15 Judge Akopchikyan?

16 JUDGE AKOPCHIKYAN: No questions. Thank you.

17 JUDGE TAY: Thank you.

18 I have two questions. Did Franchise Tax Board  
19 ever request the revenue agent report for 2010?

20 MS. DEWEY: Yes, we did. We requested both the  
21 agent report and the audit file. However, the records  
22 were not available for us at the time we made the request.

23 JUDGE TAY: Okay. Not available, like, in  
24 obtainable or destroyed? Do you have any idea?

25 MS. DEWEY: We do not have any information on why

1 we couldn't obtain the records or even if they did exist.  
2 Certainly with respect to the audit work papers, it looks  
3 like they did exist. But it's not clear that there ever  
4 was a revenue agent report issued.

5 JUDGE TAY: Okay. And the invoices that you  
6 characterize as dubious are based on source documents  
7 that, at least Appellant's witness has testified to in the  
8 form of canceled checks and things like that, were those  
9 ever reviewed by Franchise Tax Board to adjust the  
10 estimation or the calculation of subcontractor expenses?

11 MS. DEWEY: So the invoices submitted late in the  
12 audit after the auditor's preliminary decision and then  
13 the invoices, the two boxes of documents which Appellant  
14 has raised in this hearing, were reviewed. And we  
15 determine that they were not reliable evidence and could  
16 not be evidence of additional expense.

17 JUDGE TAY: Okay. Okay. I just have one more  
18 question for -- I'm going to turn to Appellant quickly.  
19 Which is, Franchise Tax Board mentioned that they allowed  
20 about \$11 million. So -- excuse me -- going to the amount  
21 in dispute here, what is your -- if you were to put a  
22 dollar amount on what you should be entitled to with  
23 regards to subcontractor expenses, what are we talking  
24 about here? What's the figure?

25 MR. SOLOMON: Let me check one minute.

1 JUDGE TAY: Sure.

2 MR. SOLOMON: It should be close since the  
3 revenue adjusted according to the FTB was \$21 million.  
4 What we believe they allowed was \$11 million, I believe,  
5 and we believe it should be close to \$19 million.

6 JUDGE TAY: Okay. Okay. I'm going to -- Mr.  
7 Ibgvy, it looks like you'd like to say something. I'm  
8 going to allow you to respond to Franchise Tax Board in  
9 your rebuttal. So if you would like to say anything --  
10 just give me one second.

11 MR. IBGVY: Go ahead.

12 JUDGE TAY: You have five minutes on rebuttal and  
13 you can feel free to respond to anything Franchise Tax  
14 Board asserted as well as make your closing statement.  
15 Okay. So whenever you're ready.

16

17 CLOSING STATEMENT

18 MR. IBGVY: Well, I mean, I just wanted to answer  
19 to the case of burden of proof. I had assumed initially  
20 that the invoices that were accepted were only from the  
21 first quarter for the first four months. But it's come to  
22 my attention that it's actually from the entire year.  
23 That would meet the burden of proving an expense for the  
24 later part of the year, you know. Whether or not the  
25 records are incomplete, your acceptance of an expense from

1 December and January should serve to prove that those  
2 expenses did occur the entire time.

3 So I feel that the burden of proof has been met  
4 regardless of the fact that I was incapable of putting  
5 forth, you know, the thousands of papers in a timely  
6 manner since it was the first year of our business. You  
7 know, we didn't expect such high volumes.

8 Thank you.

9 MR. SOLOMON: Can I say something?

10 JUDGE TAY: Please. Yes.

11

12 CLOSING STATEMENT

13 MR. SOLOMON: Okay. So the first thing I would  
14 like to say is the FTB just claimed that they ordered the  
15 documentation from the IRS but never received. We never  
16 see anything to prove that they did request, and I wonder  
17 how they requested the IRS for the documentation never  
18 received. But when I ask the IRS, I did receive a full  
19 copy of the audit. And I will read, not the account  
20 transcript, but I will read page 21 from the IRS audit  
21 report.

22 "No change to scope, an in-depth analysis and  
23 evaluation of audit potential was completed based on  
24 information developed and the scope of the examination was  
25 limited to the vital few issues. Decision to end audit,



1     50 percent rule based on information developed. It is  
2     determined that continuing of the examination of  
3     additional issues is not warranted, i.e. resulting  
4     additional taxes not expected to be material, or the time  
5     to develop additional issues is not justified, based on  
6     the potential for more tax." And that's from the IRS' own  
7     report.

8             And this is part of the report that I have  
9     provided. If you want a copy of this specific page, I  
10    can --

11            JUDGE TAY: Mr. Solomon, did you provide this to  
12    OTA?

13            MR. SOLOMON: Correct.

14            JUDGE TAY: When did you provide this?

15            MR. SOLOMON: That was part of the -- let me tell  
16    you exactly. This was --

17            JUDGE TAY: Oh, I'm sorry. I think we found it.

18            MR. SOLOMON: Yeah. You found it?

19            JUDGE TAY: Yes.

20            MR. SOLOMON: Okay. So that was a full report  
21    over 30 pages. And the transcript, the account transcript  
22    itself says that examination of the tax return was started  
23    in October 20, 2011, and then a close of the examination  
24    of tax return was in January 31st, 2014. So over  
25    two-and-a-half years of audit, and I doubt the IRS will do

1 nothing in those two-and-a-half years and close a case  
2 with no change without -- especially, with such a high  
3 volume of income. I'm talking around \$20 million without  
4 checking it and just based on the taxpayer's pretty eyes  
5 or whatever it was. So that's one thing I want to say.  
6 They never.

7 Secondly, the FTB claimed that the additional  
8 documents that we provided doesn't show the 95 percent is  
9 also incorrect. I'll refer to Exhibit 1 of the May 19,  
10 '21, the additional two boxes that I sent them for  
11 sampling the invoices. And that shows the invoice number,  
12 the check number, the income, the expense, and the profit.  
13 So claiming that those invoices, the new -- so-called new  
14 invoices does not show the profit or the 5 percent profit  
15 is completely incorrect.

16 And again, I can show you this. This was part of  
17 the documents, and that's the first time I hear this. So  
18 that's the first time I hear about the claim that it was  
19 based on the whole year. Because even the OTA in its own  
20 questions -- the questions -- the part of the three  
21 questions have mentioned that this was -- the audit was  
22 conducted based on the four months, the first four months.

23 Thank you.

24 JUDGE TAY: Okay. Thank you.

25 I'm going to turn to my Panel to see if they have

1       any final questions.

2               Judge Kletter?

3               JUDGE KLETTER:   This is Judge Kletter.   I have no  
4       final questions.   I thank the parties for their  
5       presentations today.

6               JUDGE TAY:   And Judge Akopchikyan?

7               JUDGE AKOPCHIKYAN:   I have no questions either.  
8       Thank you.

9               JUDGE TAY:   Okay.   I think I have no questions  
10      either, and I think that would be it.

11              Thank you everyone for your presentations.   The  
12      record in this appeal is now closed, and the appeal will  
13      be submitted for decision.   We will endeavor to send you  
14      our written decision no later than 100 days from today.

15              This hearing is now adjourned, and I think we are  
16      done with the morning session.   So thank you very much.

17              (Proceedings adjourned at 10:25 p.m.)  
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I, Ernalyne M. Alonzo, Hearing Reporter in and for  
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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 14th day  
of August, 2023.

\_\_\_\_\_  
ERNALYN M. ALONZO  
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