

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
K. TSE and P. JOHNSTON, ) OTA NO. 220811212  
 )  
 APPELLANT. )  
 )  
 )

## TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, July 20, 2023

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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K. TSE and P. JOHNSTON, ) OTA NO. 220811212  
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Transcript of Electronic Proceedings,  
taken in the State of California, commencing  
at 2:04 p.m. and concluding at 2:32 p.m. on  
Thursday, July 20, 2023, reported by Ernalyn M.  
Alonzo, Hearing Reporter, in and for the State  
of California.

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APPEARANCES:

Administrative Law Judge: JUDGE ASAF KLETTER

For the Appellant: ZACHARY ESTELA

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD

BRIAN WERKING

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I N D E X

E X H I B I T S

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

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

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

PAGE

By Mr. Estela 11

By Mr. Werking 20

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. Tse 8

C L O S I N G   S T A T E M E N T

PAGE

By Mr. Estela 23

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California; Thursday, July 20, 2023

2:04 p.m.

JUDGE KLETTER: So now let's go on the record.

This is the Appeal of Tse and Johnston. This is  
OTA Case Number 220811212. Today is Thursday, July 20th,  
2023, and the time is approximately 2:04 p.m. We're  
holding this hearing electronically with the agreement of  
all the parties.

My name is Judge Kletter. I'm the Administrative  
Law Judge in this Small Case Program hearing. To ensure  
we have an accurate record, please speak one at a time.  
Do not speak over each other. Please speak clearly and  
loudly. And following the hearing, the hearing transcript  
and the video recording will be produced, which will be  
available on the OTA website and are part of the public  
record.

If I can please have the parties, beginning with  
Appellant, please each identify yourself for the record by  
stating your first and last name, beginning with  
Appellant.

MR. ESTELA: My name is Zachary Estela. I'll be  
representing the Appellant Kenneth C. And Patricia  
Johnston.

MR. TSE: I'm Kenneth Tse. I'm the Appellant, I

1 guess.

2 JUDGE KLETTER: And then this is Judge Kletter.  
3 And for Franchise Tax Board.

4 MR. WERKING: Brian Werking representing  
5 Franchise Tax Board or Respondent.

6 JUDGE KLETTER: Okay. Great. Thank you.

7 And the issue for today's appeal is whether the  
8 Appellants have shown reasonable cause for the late filing  
9 of their 2020 tax return.

10 With respect to the evidentiary record, FTB has  
11 provided Exhibits A through D, and there were no new  
12 exhibits following the prehearing conference. And  
13 Appellant did not object to those exhibits. Therefore,  
14 those exhibits are entered into the record.

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

17 JUDGE KLETTER: And Appellant provided Exhibits 1  
18 through 6 following the prehearing conference, and  
19 Franchise Tax Board did not object to the exhibits. And  
20 therefore, those exhibits are entered into the record.

21 (Department's Exhibits 1-6 were received in  
22 evidence by the Administrative Law Judge.)

23 JUDGE KLETTER: And now just as a general  
24 reminder we're scheduled for approximately 60 minutes  
25 today. We'll have 15 minutes for Appellants'

1 presentation, 10 for the witness testimony, and that can  
2 be in any order, 5 minutes for FTB's questions, if any, of  
3 the witness, and then 20 minutes for FTB's presentation,  
4 and then a 5-minute closing statement by the Appellant.  
5 And I'll reminder you of all of those as we go to them.

6 Before I turn it over to Appellant for the  
7 presentation, I just want to confirm if there are any  
8 questions or -- seeing none.

9 Mr. Tse, if you could please raise your right  
10 hand, I will swear you in so we can consider your  
11 testimony.

12  
13 K. TSE,  
14 produced as a witness, and having been first duly sworn by  
15 the Administrative Law Judge, was examined and testified  
16 as follows:

17  
18 JUDGE KLETTER: Thank you.

19 Mr. Estela, are you ready to begin your  
20 presentation or call your witness?

21 MR. ESTELA: I'm ready to call my witness  
22 Mr. Tse.

23 JUDGE KLETTER: Okay. Please again.

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1 notice of explanation. And it's, you know, a reasonable  
2 cause filing, which is this form here. I'm not sure what  
3 form it is -- Form 2917. And after that it was rejected.  
4 And so I'm appealing it, and we've come to a couple turns  
5 of appeals, but I did -- so we're just appealing it.

6 And by the way, the time I did received the  
7 initial notice of that, I was -- there was a revised  
8 balance because of this penalty. I paid it immediately  
9 because I expect -- and when I spoke to the Franchise Tax  
10 Board because I thought I was going to get a refund almost  
11 right away.

12 Q Okay. And if I may, Mr. Tse I have a few  
13 questions. Have you used this tax professional before?

14 A Yes, I have.

15 Q And for how long did you use them?

16 A I believe since 2015 or '16.

17 Q 2015, 2016. Very good. And have you ever had  
18 any issues with the input of the pin before?

19 A I have not.

20 Q Okay. When the tax professional mailed your  
21 returns, did they inform you of any difference between the  
22 documents now -- at the 2020 year or any difference from  
23 then to make it seem that your returns were rejected?

24 A No.

25 Q Okay. So would it be safe to say that you relied

1       on this professional's expertise in delivering your  
2       returns for five years prior to this incident?

3           A     That's correct.

4           Q     Okay. And when you finally did receive notice of  
5       the rejection, did you take immediate action upon learning  
6       of the e-filing problem?

7           A     Yes, I did.

8           Q     Okay.

9           A     Immediately after I discovered the mail, I -- I  
10      emailed the CPA to find out what was going on, and I spoke  
11      to him. And he said yes, just sign it and send it in  
12      immediately.

13           MR. ESTELA: Very good. I have no more questions  
14      for you.

15           JUDGE KLETTER: This is Judge Kletter. I'm just  
16      curious. Is there more witness testimony, or are you  
17      going to --

18           MR. ESTELA: No this would be the end of my  
19      witness testimony. I'll begin oral argument, if that's  
20      okay.

21           JUDGE KLETTER: Yeah. Before you begin your  
22      argument -- this is Judge Kletter -- I just want to ask  
23      FTB.

24           Do you have any questions of the witness?

25           MR. WERKING: Thank you, Judge Kletter. We do

1 not have any questions.

2 JUDGE KLETTER: Thank you. Mr. Estela, you may  
3 proceed.

4 MR. ESTELA: Thank you.

5

6 PRESENTATION

7 MR. ESTELA: Members of this hearing, the issue  
8 at hand is whether the Appellants Kenneth Tse and Patricia  
9 Johnston have shown that the failure to file a timely tax  
10 return for the year 2020 was due to reasonable cause and  
11 not willful neglect, as held in California Code Revenue &  
12 Taxation Code Section 19131 subsection (a). And we  
13 understand, as soon you will, that based on the standard  
14 required by this hearing, a preponderance of the evidence  
15 more likely than not, we have done just that.

16 First, let us make evident the reality that the  
17 applicant -- Appellants did indeed make reasonable efforts  
18 to file their returns timely. As evident in Exhibit 1,  
19 the complete DocuSign return dated October 15th, 2021, we  
20 see that the Appellants' tax return was completed and  
21 signed off on time. Furthermore, Exhibit 3, the email  
22 confirmation following payments of tax liability for the  
23 2020 tax year also on October 15th, 2021, show that the  
24 Appellants paid his tax liability for the 2020 year; and  
25 more importantly, that the Appellant did indeed, to the

1 best of their knowledge, timely file the 2020 tax return  
2 for both state and federal.

3 We can realize this. You can realize this. And  
4 even the FTB can realize this, as they received the tax  
5 returns on time and rejected those returns on account of  
6 the IRS' rejection for incorrect information. In this  
7 case, Mr. Tse's pin being incorrect. Again, filed on  
8 time, received, but rejected. Now while Section 4 of the  
9 FTB publication 1345 states and I, quote, "Tax returns  
10 acknowledged as rejected are considered not filed."

11 But the protocol of a rejection is not the same  
12 as a failure to file. This is not just our belief, but  
13 it's both an IRS and FTB belief. The IRS in IRC  
14 6724(d)(1) defines failure to timely file and failure to  
15 input correct information as separate individual failures.  
16 Indeed, on the FTB protocol for rejected e-file returns,  
17 as listed on their website under their e-file calendars,  
18 is to notify the taxpayers about the rejected timely filed  
19 returns. And again I quote, "Give five calendar days past  
20 all return due dates to retransmit -- to be retransmitted  
21 and considered timely." Retransmitted and considered  
22 timely.

23 Thus, upon notice of the rejection, Appellants  
24 would have by the FTB's own protocol have been able to  
25 timely file their returns. But unfortunately, that notice

1       only came to the Appellants when the FTB had already  
2       applied penalty after penalty. And that, members of this  
3       hearing, is precisely what is at the core of today's  
4       hearing, whether if the failure of the Appellants to  
5       receive notice of their rejection, which ultimately  
6       resulted in their inability to timely was due to  
7       reasonable cause or willful neglect.

8               And again, based on a preponderance of the  
9       evidence, the standard required for this appeal, we will  
10      show you that it was due to reasonable cause. Returning  
11      first to the IRS publication 1586, reasonable cause  
12      regulations and requirements for missing and incorrect  
13      name, TIN, on information returns. As it is the  
14      overarching rules for precisely the issue at hand of an  
15      incorrect pin.

16             To show that the failure to include a correct TIN  
17      was due to reasonable cause and not willful neglect, the  
18      IRS requires the filers must establish both that they  
19      acted in a responsible manner both before and after the  
20      failure occurred. Here, we've shown by virtue of  
21      Exhibit 1 and 3 that Appellants acted responsibility  
22      before. And we've established that Mr. Tse immediately  
23      corrected the mistake and refiled when he finally received  
24      notice of the rejection.

25             The IRS also requires that there be significant

1 mitigating factors with respect to the failure. The IRS  
2 provides the example in established history of filing  
3 information returns with correct TINs. Here, Mr. Tse has  
4 explained that he has used this tax professional before in  
5 the tax year in question, satisfying this requirement.  
6 But even still, the IRS provides a second option, that the  
7 failure was due to events beyond the filer's control,  
8 providing an example of actions of the payee or any other  
9 person.

10 Here, the failure to include the correct pin in a  
11 timely fashion was the fault of the tax professional as  
12 she did not notify Mr. Tse of the rejection. Indeed their  
13 failure as a tax professional to comprehend and  
14 communicate the five-day window to Mr. Tse in an efficient  
15 and obvious manner led to Mr. Tse never receiving notice  
16 of the rejection. We ask that this hearing use the IRS  
17 publication 1586 as a reference for this appeal, as it  
18 addresses the actual issue that resulted in the  
19 Appellants' rejection, and also shows how by the legal  
20 standard held by the IRS, Appellants' failure was due to  
21 reasonable cause and not willful neglect.

22 Turning now to the FTB. They rely on precedent  
23 set in United States V. Boyle in the appeal of Thomas Kay  
24 and Gail G. Boehme, that each taxpayer has a personal  
25 nondelegable obligation to file a tax return by the due

1 date. But again, the FTB's assumption is incorrect  
2 because this is not a case in which the Appellant relied  
3 on a tax professional to timely file by the due date. But  
4 rather, the Appellants here relied on a tax professional  
5 competency in the subject of tax law which includes the  
6 e-filing protocols of the FTB.

7 The tax forms were rejected by the FTB because of  
8 federal rejection, a federal rejection that we just  
9 established would likely see -- would likely be seen as a  
10 reasonable cause, mind you. Notice of the rejection was  
11 sent to the tax professional, but they did not communicate  
12 this in a timely manner to the Appellants. Instead the  
13 professional treated the rejection as they had treated  
14 acceptance of tax returns in the past, by mail to an old  
15 address mind you. Even had Mr. Tse been at the San  
16 Francisco location, there is no guarantee that he would  
17 have received the mail pamphlet explaining the rejection  
18 in time to satisfy the five-day window.

19 In United States v. Boyle, if a taxpayer relies  
20 on improper substantive advice of an accountant or tax  
21 attorney as to a matter of tax law, such as whether the  
22 taxpayer has a tax liability, failing to file a return,  
23 pay the tax shown on the return by the due date may be  
24 considered reasonable cause if certain conditions are met.  
25 These conditions include the person reasonably relied on

1 by the taxpayer is a tax professional with competency in  
2 the subject of tax law, and the tax professional's advice  
3 is based on the taxpayer's full disclosure of the relevant  
4 facts and documents.

5 Thus, Appellants have again proven reasonable  
6 cause by preponderance of the evidence because after  
7 having made every reasonable step to timely file their  
8 returns, they relied on the competency of a tax  
9 professional that they had used for so many years, a  
10 competency that should have understood the five-day window  
11 set by the FTB to retransmit rejected timely filed returns  
12 and have them accepted as timely filed, and notify the  
13 Appellants in a manner that would provide actual notice.

14 And this tax professional's action in using snail  
15 mail to the wrong address to provide notice to Appellants  
16 was, in fact, based on full disclosure of relevant facts  
17 and documents. They had shared emails regarding the  
18 returns just days before the filing and rejection. The  
19 tax professional had access to Mr. Tse's email.

20 And finally, in their brief and in an attempt to  
21 argue that notice was sufficient, the FTB assumes the  
22 position that Appellants did not assume the ordinary  
23 intelligence of prudent business persons by not routinely  
24 and almost paranoidly checking whether the taxes were  
25 accepted. In their brief, FTB presents a description of a



1 taxpayer who electronically files their taxes and then  
2 continues to check, recheck, and check again the e-file  
3 history and acknowledgment record to confirm acceptance.

4 However, this presents an ordinary intelligent  
5 and prudent businessperson as someone who is immediately  
6 distrustful of the electronic filing process or any  
7 process for that matter. As the saying goes, if something  
8 isn't broke, why fix it. If you receive confirmation of  
9 your taxes being sent, why paranoidly check to see if it  
10 was accepted? The FTB themselves state in the second line  
11 of page 4 of their brief that in regular electronic  
12 filing, the taxpayer or professional will receive a  
13 message of confirmation of whether the return has been  
14 accepted or rejected.

15 Thus, the FTB's very purpose of sending a  
16 confirmation message of rejection leaves the notion that  
17 an ordinarily intelligent and prudent businessperson  
18 wouldn't constantly check, recheck, and just simply wait  
19 for the notice that the FTB sends. Does the FTB suggest a  
20 moderately intelligent person should distrust the FTB in  
21 doing their job? And if notice of rejection never comes,  
22 why should the taxpayer assume the worst case scenario,  
23 especially, as everything seemingly is business as usual.

24 A mail pamphlet of tax return documents sent to  
25 an address, is it more likely that this all meant to the

1 Appellants business as usual and rightfully assumed  
2 acceptance, especially, when you are relying on the  
3 competency of a tax professional who should know of the  
4 FTB's five-day protocol to e-file rejections and has  
5 access to your documents and contact information and was  
6 just emailing you a few days prior? Again, this is a  
7 reliance that U.S. V. Boyle likely establishes as  
8 reasonable and IRS publication 1586 likely establishes as  
9 reasonable.

10 Because the e-filing was handled by the CPA, the  
11 tax professional, the notice and messages from FTB were in  
12 the professional's control. Appellant had no way of  
13 knowing the e-filing had been rejected because Appellant  
14 did not receive the notice. The tax professional sent it  
15 by mail to the wrong address, and then did not just email  
16 the Appellant or inquire about any new contact information  
17 or addresses. Thus, Appellant did not -- did exercise  
18 ordinary intelligence of a reasonable businessperson by  
19 trusting other professionals to be professional and notify  
20 the Appellants of the issue with their 2020 taxes.

21 In conclusion, Appellants have established by a  
22 preponderance of the evidence that their failure to file a  
23 timely return was due to reasonable cause. Their untimely  
24 file was despite the ordinary business care and prudence  
25 they exercised in filing their return on the due date and

1       rather due to the lack of notice they received by relying  
2       on their tax professional's competency and access to all  
3       their documents. And finally, they did exercise the  
4       ordinary intelligence of a businessperson by trusting the  
5       FTB, and their tax professional would have notified them  
6       as is the normal system.

7               When Appellants learned of the rejection, they  
8       took immediate action to resolve the discrepancy. And  
9       more likely than not, would have satisfied the five-day  
10      window allowed by the FTB had they just received the  
11      notice. Thus, Kenneth Tse and Patricia Johnston have  
12      shown that their failure to file a timely tax return for  
13      the year 2020 is due to reasonable cause and not willful  
14      neglect, thus, satisfying California Code -- Revenue &  
15      Taxation Code Section 19131 subsection (a).

16             We ask that this hearing find in favor of the  
17      Appellants and approve their appeal.

18             Thank you.

19             JUDGE KLETTER: This is Judge Kletter. Thank you  
20      so much, Mr. Estela, for your presentation.

21             I will now turn it over to the Franchise Tax  
22      Board. You will have 20 minutes.

23             Mr. Werking, are you ready to begin your  
24      presentation?

25             MR. WERKING: Yes, I am. Thank you, Judge.

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1       October 15th and October 16th, but Appellants did not take  
2       any steps to inquire, correct the issue, or otherwise  
3       ensure that the California tax return was successfully  
4       transmitted to and accepted by FTB. FTB did not receive  
5       Appellants' 2020 tax return until January 27th, 2022, more  
6       than nine months late and accordingly imposed a late  
7       filing penalty.

8               To abate the late filing penalty, Appellants must  
9       establish that their failure to timely file was due to  
10      reasonable cause and not willful neglect. To establish  
11      reasonable cause, the taxpayer must show that their  
12      failure to timely file a return occurred despite the  
13      exercise of ordinary business care and prudence.

14             In the Appeal of Quality Tax and Financial  
15      Services Incorporated, OTA has previously held that  
16      ordinary business care and prudence requires a taxpayer to  
17      ensure their return submitted for e-filing was  
18      successfully transmitted to and accepted by FTB. In the  
19      absence of an acknowledgment that a return was  
20      transmitted, received, or accepted, an ordinarily  
21      intelligent prudent businessperson would have viewed the  
22      e-file history acknowledgment records to confirm whether  
23      the return had been timely transmitted and accepted by  
24      FTB.

25             Appellants' inaction between the time they

1 authorized their preparer to electronically file their  
2 return on October 15th and the time they mailed their  
3 return on January 27th is not an example of business care  
4 and prudence. Appellants had a nondelegable duty to file  
5 the California tax return. And that duty continued until  
6 the day FTB received their return on January 27th, 2022.  
7 Appellants' failure to timely file their return, even if  
8 an unintentional error was avoidable, had they exercised  
9 due care and verified that their returns had been  
10 transmitted and accepted or rejected.

11 As such, Appellants have not met their burden to  
12 establish that their failure to timely file their 2020  
13 California tax return was due to reasonable cause.  
14 Accordingly, the imposition of the late filing penalty was  
15 proper and should be sustained.

16 Thank you, and I'm happy to answer any questions  
17 the OTA may have.

18 JUDGE KLETTER: This is Judge Kletter. I do not  
19 have any questions.

20 I just want to check with Mr. Estela.

21 Would you like to make a final statement or  
22 rebuttal to what Mr. Werking said, or is there anything  
23 else that you would like to mention or have prepared  
24 before the case is submitted?

25 MR. ESTELA: Yes, I just have a few points.

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CLOSING STATEMENT

MR. ESTELA: Again, the FTB suggests diligent steps and reasonable business persons again would distrust the tax professional and the FTB in providing the notice that the FTB provides. So because Mr. Tse did not receive the notice, is the core of this case, not whether they took the steps to try to distrust the FTB. That is -- that's the point.

Thank you.

JUDGE KLETTER: Okay. If there's isn't anything else, this concludes our hearing for today.

The case will be decided based on the documents and the testimony that was presented. The OTA will issue our written decision no later than 100 days from today. This case is submitted, and the record is now closed.

This concludes this hearing session for today, and the next session will begin tomorrow July 21st at 9:30 a.m.

Thanks everyone for your time today.

(Proceedings adjourned at 2:32 p.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for  
the State of California, do hereby certify:

That the foregoing transcript of proceedings was  
taken before me at the time and place set forth, that the  
testimony and proceedings were reported stenographically  
by me and later transcribed by computer-aided  
transcription under my direction and supervision, that the  
foregoing is a true record of the testimony and  
proceedings taken at that time.

I further certify that I am in no way interested  
in the outcome of said action.

I have hereunto subscribed my name this 9th day  
of August, 2023.

\_\_\_\_\_  
ERNALYN M. ALONZO  
HEARING REPORTER