

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	)	
	)	
T. AMBRAMSON and A. AMBRAMSON,	)	OTA NO. 21067893
	)	21119139
	)	
D. TEIGER and S. WEINTRAUB-TEIGER	)	21118984
	)	
APPELLANT.	)	
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TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Wednesday, September 20, 2023

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Electronic Proceedings,  
taken in the State of California, commencing  
at 10:32 a.m. and concluding at 12:29 p.m.  
on Wednesday, September 20, 2023, and again  
commencing at 2:01 p.m. and concluding at  
3:45 p.m. on September 27, 2023, reported by  
Ernalyn M. Alonzo, Hearing Reporter, in and  
for the State of California.

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APPEARANCES:

Panel Lead: ALJ VERONICA LONG

Panel Members: ALJ OVSEP AKOPCHIKYAN  
ALJ JOSHUA LAMBERT

For the Appellant: KREIG MITCHELL  
T. AMBRAMSON

For the Respondent: STATE OF CALIFORNIA  
FRANCHISE TAX BOARD

NATHAN HALL  
JASON RILEY

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-53 were received at page 6.)  
(Department's Exhibits A-AA were received at page 6.)

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California; Wednesday, September 20, 2023  
10:32 a.m.  
DAY 1

JUDGE LONG: We are on the record.

We are opening the record in the consolidated Appeals of Abramson and Teiger, OTA Case Nos. 21067893, 21118984 and 21119139. This matter is being held before the Office of Tax Appeals. Today's date is Wednesday, September 20th, and the time is approximately 10:32 a.m.

My name is Judge Long, and I am the lead Administrative Law Judge for this appeal. With me today are Judges Ovsep Akopchikyan and Josh Lambert.

As a reminder, the Office of Tax Appeals is not a court. It is an independent appeals body. The office is staffed by tax experts and is independent of the State's tax agencies.

With that, I'm going to ask the parties to please introduce themselves for the record, starting with Appellants.

MR. MITCHELL: Yeah. Craig Mitchell, attorney here for Appellants.

MR. ABRAMSON: Trevor Abramson for Abramson Teiger Architects.

JUDGE LONG: All right. And FTB.

1 MR. HALL: Nathan Hall here for Respondent FTB.

2 MR. RILEY: Jason Riley for Franchise Tax Board.

3 JUDGE LONG: Okay. All right. Thank you.

4 As confirmed at the prehearing conference and in  
5 my minutes and orders following that conference, the issue  
6 to be decided in this appeal is whether Appellants have  
7 demonstrated that Abramson Teiger Architects is entitled  
8 to research and development tax credits for tax years 2013  
9 through 2017.

10 Next, I'd like to move on to the evidence in this  
11 appeal. Appellants have submitted Exhibits 1 through 53.  
12 FTB has indicated they do not have any objection to these  
13 exhibits. As such, Appellants Exhibits 1 through 53 are  
14 now admitted and entered into the record.

15 (Appellant's Exhibits 1-53 were received  
16 in evidence by the Administrative Law Judge.)

17 JUDGE LONG: FTB has submitted Exhibits A through  
18 AA. Appellants indicated they do not have any objection.  
19 As such, Exhibits A through AA are now admitted and  
20 entered into the record.

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

23 JUDGE LONG: Now, I'd like to go over the order  
24 of the proceedings today. In my minutes and orders, I  
25 indicated that each party begin -- Appellants will have

1 five minutes for their opening statement. FTB will have  
2 five minutes for their opening statement. Appellant's  
3 case presentation, including witness testimony will be 90  
4 minutes. There will be an opportunity for the panel and  
5 FTB to question the witness regarding factual testimony.  
6 And then FTB's presentation will be 90 minutes, and then  
7 Appellants will have 10 minutes for rebuttal.

8 With that said, our allotted time for the morning  
9 calendar ends between 12:00 and 12:30. And need be, we'll  
10 continue this case. With that, I think we're ready to  
11 begin.

12 Mr. Abramson has indicated that he plans to  
13 testify, so I'm going to swear Mr. Abramson in.

14 I'm going to ask you to please raise your right  
15 hand, Mr. Abramson.

16  
17 T. ABRAMSON,  
18 produced as a witness, and having been first duly sworn by  
19 the Administrative Law Judge, was examined, and testified  
20 as follows:

21  
22 JUDGE LONG: Thank you, Mr. Abramson.

23 Appellants, you have five minutes to make your  
24 opening statement. You may begin whenever you're ready.

25 MR. MITCHELL: Thank you, Judge.

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1 shrink-back rule, and we'll get into that in our  
2 presentation. But he refers to that rule as an error and  
3 then asserts in his summary in his audit report that  
4 instead of figuring out that error and taking the time to  
5 do so, he's just going to say that the time is not  
6 qualified.

7 So the taxpayers are required to apply the  
8 shrink-back rule. And, again, we'll get into that in our  
9 presentation. But, essentially, it's applying the  
10 research tax credit rules at a smaller subset. And so the  
11 taxpayers are required to do so. And, in fact, if you  
12 look at the growing body of research tax credit court  
13 case, almost all of those where the taxpayer was  
14 unsuccessful is because they didn't apply the shrink-back  
15 rule. And in our case we did apply it, and the auditor  
16 didn't under understand it. So I think that's why we're  
17 here today primarily.

18 Now, when this case got assigned to the FTB for  
19 the appeal, the attorneys at the FTB quickly realized that  
20 they didn't have a basis that was generated in the audit  
21 report. And so they used the appeals process to basically  
22 conduct a whole audit during the appeals process. And  
23 they did this by raising a score of new issues that had  
24 not been raised before at the examine level. For example,  
25 the FTB in its audit report, it says on page -- on page 4,

1 the auditor says that we pinpointed the business  
2 components. And I will explain that later in the  
3 presentation.

4 But while the auditor says we pinpointed them,  
5 for the first time on their brief, the FTB says on page 12  
6 of their brief, that we didn't even identify them. So an  
7 entirely new issue raised in appeals, and that's not the  
8 only issue that was new. That's not an isolated example.  
9 Their briefs are loaded with new issues. It's the  
10 taxpayers' position that the FTB has the burden on all of  
11 its new issues, and we believe that's the law in  
12 California. It's law at federal level. It's the law at  
13 every state that I'm aware of. And we cited the authority  
14 for that in our second reply brief in Footnote 5.

15 As for the substance of the case, the FTB has  
16 taken a shotgun approach. It's basically raising any and  
17 all issues it can for the R&D credit, and it's hoping that  
18 something will work. And when it does so, it's  
19 misconstruing the law. It's omitting relevant court and  
20 legal authorities, and mischaracterizes the facts.

21 Now, we live in the sound-bites society where  
22 sound bites rule the day, and it's okay for some to make  
23 sound bites, like politicians. But that's not appropriate  
24 for the FTB. That's not appropriate for an appeal. The  
25 auditor should taken the time to understand the facts and

1       apply the facts to the law -- or the law to the facts.  
2       And then on the appeal, they shouldn't raise all these new  
3       issues for the very first time. Raising that many issues  
4       is unfair, and it is contrary to what an appellate process  
5       is supposed to be.

6               Now, an objective review of the facts and the  
7       evidence in this case is going to show that the taxpayers  
8       are entitled to the research tax credits. We've provided  
9       several thousand pages of records to the auditor, and many  
10      of those are in the record for these case. I'm going to  
11      go through some of those in my presentation, we're also  
12      going to have Mr. Abramson talk and go through some of the  
13      projects that were sampled. And that's going to show that  
14      the taxpayers fully qualify for the credits, and the FTB's  
15      arguments and its new arguments don't have any bearing on  
16      our credits.

17             Thank, you, Judge.

18             JUDGE LONG: Thank you.

19             FTB, you may begin your opening statement when  
20      you're ready.

21             MR. HALL: Thank you.

22

23                             OPENING STATEMENT

24             MR. HALL: For the taxable years at issue,  
25      Appellants filed amended returns seeking refunds based on

1 the California research credit. Appellants Trevor  
2 Abramson and Douglas Teiger claimed that these credits  
3 flowed through to them from the architectural firm,  
4 Abramson Teiger Architects, as partners of the firm. The  
5 California research credit largely mirrors the  
6 requirements and exclusions of the federal research  
7 credit.

8 To show entitlement to the credit, taxpayers must  
9 demonstrate through research documentation satisfaction of  
10 a rigorous four-part test. Additionally, there are  
11 several exclusions from qualified research under which  
12 even qualified activity is considered ineligible for the  
13 credit. As explained in Respondent's briefing and as will  
14 be explained today, there are many number of reasons why  
15 Appellants have failed to demonstrate entitled to the  
16 claimed credits. However, it is important to bear in mind  
17 that where any single exclusion applies, or any single  
18 test is not satisfied, the taxpayer is wholly ineligible  
19 for the credit. In other words, to demonstrate  
20 eligibility for the claimed credits, Appellants must  
21 prevail as to every contested matter raised in these  
22 appeals.

23 Appellants maintain that the burden of proof has  
24 shifted to Respondent. This is incorrect. The burden  
25 lies with Appellants to substantiate their refund claims,

1 and Appellants have failed to satisfy that burden. In  
2 particular, Appellants have failed to demonstrate that the  
3 contracts entered into by Abramson Teiger should not be  
4 excluded under the funded research exception. Here, all  
5 contracts at issue were funded by their respective  
6 clients. Appellants have failed to demonstrate that the  
7 fruits of the claimed research, which are protected under  
8 copyright law, are not excluded as research in the arts.

9 Furthermore, even if Appellants could show that  
10 these exclusion do not apply, Appellants have failed to  
11 satisfy their burden with respect to the four-part test  
12 for qualified research. Appellants have failed to  
13 identify their business components. Appellants have  
14 failed to demonstrate satisfaction of the Section 174  
15 Test, which requires taxpayers to demonstrate, among other  
16 things, uncertainty in the development or improvement of a  
17 product. Appellants have failed to demonstrate that much  
18 of their purported research satisfies the technological  
19 and nature test. And finally, Appellants have failed to  
20 demonstrate the use of a process of experimentation for a  
21 qualified purpose with respect to substantially all or  
22 80 percent of their qualified activity. The documentation  
23 provided by Appellants does not establish qualified  
24 research.

25 Moreover, Appellants conflate the design process

1 with the process of experimentation under Section 41 and  
2 claim that creating a new design is prima facie evidence  
3 for qualified research. However, this argument has been  
4 rejected by the Tax Court and Appellate Courts in cases,  
5 such as Little Sandy Coal versus Commissioner.

6 Respondent reminds the Panel that statutes  
7 granting tax credits must be strictly construed against  
8 the taxpayer, with any doubts resolved in Respondent's  
9 favor, and tax credits are a matter of legislative grace.  
10 Taxpayers bear the burden of proving they are entitled to  
11 any claimed tax credits. Appellants have failed to  
12 demonstrate their burden to show error in Respondent's.

13 Thank you.

14 JUDGE LONG: All right. Thank you, Franchise Tax  
15 Board.

16 With that, Appellants you have 90 minutes for  
17 your case presentation, including witness testimony. You  
18 may begin whenever you're ready.

19 Mr. Mitchell, I believe you're muted.

20 MR. MITCHELL: Thank you, Judge. I'd like to try  
21 to share my screen to start with Demonstrative No. 1. So  
22 I'm going to attempt to do that. So let me give that a  
23 try. I would ask is -- are you able to see my screen?

24 JUDGE LONG: Yes, I am.

25 MR. MITCHELL: Thank you, Judge.

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10                   So conceptionally, as depicted on the  
11       demonstrative, there are two parts to the production of  
12       something new and novel. Typically, there's usually a  
13       design phase, and then there's a manufacturing phase. And  
14       so generally the design phase ends when you have a final  
15       design and you move onto the manufacturing aspect of it.  
16       Now, you can see that depicted on the screen. So on the  
17       right-hand side of the screen -- I'll call that the right  
18       quadrant, if you will -- for manufacturing, and then the  
19       left-hand side for design work.

Generally, on the left-hand side of the screen, research is found in some aspects of the design effort. So the reason why the blue line is the demonstrative is it's indicating that below that line is generally the research activities, and above it is not. And so this is getting a bit ahead of myself. I'll come back to it. But

1 if you look at the court cases, in particular the court  
2 cases cited by the FTB, they are almost exclusively cases  
3 where taxpayers are on the right side of the screen, the  
4 right quadrant.

5 They are manufacturers who are trying to take  
6 time and credit for manufacturing activities. Almost  
7 without exclusion, that's the case in the court cases  
8 that -- for the R&D credit where taxpayers are trying to  
9 take credit for their design work the -- without  
10 exception, there are only cases where the taxpayers did  
11 not have records to identify what research in their design  
12 efforts was qualified and non-qualified. So to put it  
13 shortly, on the left-hand quadrant of the screen, the  
14 taxpayers in those cases did not have the records to note  
15 what research was above and what research was below the  
16 blue line that's on the demonstrative.

17 Now, with that said, let's see if I can get -- so  
18 the second page, this is demonstrating the rules for the  
19 R&D credit. Again, it's the Section 41 R&D credit and  
20 also the California statute that's very similar and builds  
21 on it. Now, the first step is to identify qualified  
22 research expenses. And as depicted on this slide, we only  
23 have wage expenses here, so wage qualified research  
24 expenses. We don't have the other buckets of supply cost,  
25 computer rental, or contract cost.



1           So what this slide is depicting is the research  
2     expenses are the wage expenses, and that's payroll data.  
3     And so I don't believe the FTB is challenging the payroll  
4     data, but that's in the record. The R&D credit studies  
5     have attached to them a summary of the W-2 records, and I  
6     don't think the amount of the wages is in issue. Now, on  
7     the screen it's also showing a red arrow on the left, and  
8     it indicates Exhibit 32. I'm going to go into Exhibit 32  
9     quite a bit, and so I'll come back to that. But those are  
10    the contemporaneous time records that the taxpayer kept  
11    independent of the research tax credit, and then the other  
12    yellow highlight is for project documents.

13           And we have various exhibits that have been  
14    admitted into the record here that are project documents.  
15    And the reason why Exhibit 32 and the project documents  
16    are important is they allow you to take the qualified  
17    expenses and then go to step 2, which is identifying the  
18    qualified research activities. And once you've identified  
19    those, then we can apply the four-part test and the  
20    exclusions to make sure that we're only picking up  
21    qualified time.

22           Now, looking at the right-hand side of the  
23    screen -- this is getting ahead of myself a little bit  
24    again -- but this is an overview. You can see on the  
25    right-hand side of the screen I have a chart here, and the

1 chart lists the years at issue. It lists the total wages  
2 that were reported on the tax returns. So it lists the  
3 \$15 million. And then it lists what was picked up by the  
4 study provider for the research tax credits as qualified  
5 wages. So it's noted that we applied the shrink-back rule  
6 to get to those qualified research expenses. And so as  
7 you can see on this slide, the total is about 40 percent  
8 if you look at all the years.

9 Now, the FTB in its briefing apparently didn't  
10 realize that because in several instances the FTB is  
11 asserting that the taxpayer is picking up all of their  
12 time, and that's not the case. It's not even 50 percent.  
13 Now, if you were to look at Exhibit 32 -- this  
14 demonstrative, by the way, says 2017 on the first entry.  
15 That should actually be 2016. That is a typo. But  
16 Exhibit 32 is the 2016 time records that the taxpayer  
17 kept. These are actual time entries from the employees  
18 that work for the taxpayer. As we're going to see,  
19 there's about 30 to 40 employees in any given year. The  
20 records themselves are not only contemporaneous, they're  
21 detailed.

22 This Exhibit 32 is just one of the year's  
23 records, and it's over a thousand pages long. Now, the  
24 other years we have the exact same records. And in the  
25 FTB's audit report in Exhibit 1, it actually provides a

1 summary of all the other years. So it was kind of enough  
2 to spend time sorting and putting it into summary form so  
3 that it actually took the records from a thousand pages  
4 for the other years and shortened them down, but they are  
5 based on the exact same records as this one, and on the  
6 screen I have it depicted.

7 What you're looking at here is a snippet of  
8 Exhibit 32, and the red arrows are pointing to the six  
9 items of data that's captured by this record. And so I  
10 don't know if you can see it if it's too small, but it  
11 actually identifies the project. It identifies the phase,  
12 which is schematic design. It identifies the employee  
13 that was putting in their time, the date they put in their  
14 time, the amount of hours they worked that day on the  
15 project, and a description. So on this one it's talking  
16 about three-dimensional Revit model. That's the activity  
17 in the description.

18 So these six data points are how the basis of the  
19 R&D tax credit. If you were to actually look at  
20 Exhibit 32 and really study it, you would see that the  
21 design activities are for modeling, calculation, energy  
22 efficiency, and structural integrity. You would also see  
23 that there is a structured process that has very set  
24 phases for each project that each project has to go  
25 through. So on the screen you can see a chart, and the

1 numbers on that chart are generally the phases as time is  
2 going by.

3 So one of FTB's arguments is, well, you,  
4 taxpayer, are picking up, you know, 100 percent or  
5 70 percent or 90 percent of your time, and we're going to  
6 see that and how they get there. If you look at the  
7 chart, what they're doing is where the research activity  
8 increases in the chart and the plateaus, that plateau may  
9 be an entire year because these are multiyear project.  
10 They don't cut off neatly within one year. And the FTB is  
11 taking basically the position that you have to look at it  
12 on a single-year basis, but these are not year basis  
13 projects. They run three, four, five, six years.

14 And so by only looking at the plateau, the FTB is  
15 concluding that the taxpayer is taking a lot or too much  
16 hours. And we'll come back to that. So if you were to  
17 look at Exhibit 32 and really study it, you would see that  
18 these are the phases that are picked up. These phases  
19 start with a design and data gathering. They go through a  
20 schematic design phase, a design development, construction  
21 documents, bidding, and then there's additional services  
22 and consulting.

23 So what you're going to see is those phases  
24 generally line up with the scientific method. They start  
25 with hypothesis, data gathering, analysis, and discarding

1 or proving the thing that is hypothesized. And so that --  
2 those are the phases included, generally, in Exhibit 32.  
3 The naming is slightly off on different projects, but it's  
4 very similar to this.

5 Now, what is not included in Exhibit 32 is the  
6 very thing that I think the FTB, because the way it  
7 handled the case ask raised these issues for the first  
8 time on appeal, I don't think, in reading their briefs,  
9 that they understand that what they're not seeing on  
10 Exhibit 32 are the items that were taken out. And so, for  
11 example, on the screen we have several phases that were  
12 not included in Exhibit 32.

13 So you have a bidding and proposal phase that  
14 goes through and makes drawings and does the initial data  
15 gathering before you actually get to a project. And then  
16 there's the permitting, and then importantly the  
17 supporting services. We're going to come back to  
18 supporting services. Almost all of these were excluded  
19 because they were hourly. And there's a rule, a funded  
20 research rule that we'll cover towards the end of the  
21 preparation. So most of these were almost, without  
22 exception, excluded.

23 But the FTB didn't know that because, even as of  
24 today, I don't believe they realize that they're only  
25 looking at a record where items have already been removed.

1 And so in their brief, for example, the FTB goes on at  
2 length about one of the exclusions for the research  
3 credit. There's an exclusion for arts, humanities, and  
4 social sciences. So for those activities, they don't  
5 qualify. Well, the FTB didn't even realize, apparently,  
6 that those would be in the interior design, drafting, and  
7 rendering phases, which were not even included in the R&D  
8 credit calculation. They were specifically excluded  
9 already. And so we address that in our brief, but it's  
10 proven out by Exhibit 32 and the other records.

11 So one of the new issues that the FTB raises is  
12 the business component. So, again, the auditor said that  
13 these were pinpointed. That's in the AIPS in Exhibit  
14 Number 1. But now on briefing the FTB is saying that the  
15 business component was not identified. So I have the  
16 definition of business component here on the screen. It's  
17 set out in Section 41(d)(2)(B), and it is defined as  
18 any -- and it has the word "any" -- product, process,  
19 computer software, technique, formula, or invention. Now  
20 these sub-elements here are not defined in code or the  
21 regulations.

22 Now, I want to stop to focus on the word  
23 "formula." So perhaps the most common formula is -- one  
24 that comes to mind is the formula for Coca-Cola. And so  
25 if you're trying to think well, what's the formula? To

1 me, that is a symbolic representation of it because what  
2 formula is in that context is a string of mathematical  
3 numbers that represent different chemical elements that  
4 allow you to -- whoever has it, to actually go out and use  
5 that formula to produce or manufacturer an item, which is,  
6 for example, Coca-Cola.

7 So that's very similar to the common definition  
8 for the term formula. So the term formula in the  
9 dictionary generally has synonyms such as design or  
10 blueprint. And that really is kind of what we have here.  
11 So when you think about an architect and engineer, what  
12 are they really selling to their client? And the answer  
13 is they are selling the design and blueprints for how to  
14 make these complex novel new-to-the-world building  
15 structures that resolve all the technical uncertainties.  
16 And someone can basically take that that blueprint and go  
17 and design or manufacture that component. So the business  
18 component is just that. It's the formula. It's the  
19 blueprint. It's the thing that identifies the building  
20 structure that's depicted in the design drawings.

21 Now, the business component is looked at by  
22 applying the shrinking-back rule. I alluded to this in  
23 the opening. Here's its regulation that sets out the  
24 Rule. It's 1.41-4. I won't read this verbatim. The gist  
25 of it is you have to shrink-back. So when you're applying

1 the four-part test and the exclusions, you shrink back the  
2 business component first, and then you look at the most  
3 narrow subset to see where the four-part qualifies. I  
4 have on the screen here an example from the regulations.  
5 This is example 4 from 1.41-4(a)(8). Now, there are other  
6 examples in the same regulation, but this one kind of  
7 demonstrates the shrinking-back concept.

8 So in this example, it's talking about engineers  
9 who are uncertain how to design a car hood. And they're  
10 trying to design the car hood, no doubt to make it pretty  
11 for aesthetics, but really the focus is on the increased  
12 fuel economy. I'm just assuming it's because aerodynamics  
13 are something similar. But the example says that that  
14 actually qualifies. So that's qualifying time. But as  
15 far as the business component goes, you can see how you  
16 don't take credit for the entire car. You take it for the  
17 hood. So your time is applied on the hood and doing  
18 design work for the hood.

19 I also pause to note that this example is very  
20 similar. The energy efficiency is much more simple in  
21 this example than what the client -- my client does,  
22 Abramson Teiger, for their energy modeling. So the energy  
23 modeling in our case is actually much more complicated and  
24 technical than what is set out in this example. Now, so  
25 what does that tell us? That tells us when we look at



1     what we have to do here in figuring out the credits, we  
2     have to exclude the manufacturing time, so the right-hand  
3     quadrant of the screen. And then on the left-hand  
4     quadrant of the screen we have to shrink back to the  
5     design activities that are qualified research.

6             And how we do that is, there's a couple of  
7     methods that have been developed over time in the research  
8     tax credit study industry. And the IRS was kind enough to  
9     actually set those out in its briefing paper, which I  
10    believe that's in Exhibit 53. But the briefing paper sets  
11    out three different methods for computing R&D credits. Of  
12    the methods, the IRS has concluded that the primary and  
13    most credit method is the IRS's project approach. Now, I  
14    have that on the screen here. What it shows is that the  
15    taxpayer is supposed to take the cost associated with each  
16    project and look at the activities for each project to  
17    identify the qualified research expenses. This is in  
18    comparison to the other two approaches that are set out in  
19    the IRS' briefing paper.

20            Now, the reason why the IRS highlights the  
21    project approach is because it's the one that provides the  
22    nexus from the expense, meaning the payroll expense, to  
23    the actual activity. Now, you see to get there you have  
24    to have a record such as our Exhibit 32. The reason why  
25    most taxpayers don't apply this IRS method, this preferred

1 method, is because they don't have that record that we  
2 have in this very case. And so by having the record,  
3 we're able to go in and apply and use the project method  
4 that's provided by the Internal Revenue Service.

5 And here's how we did it. So this is set out  
6 again in the research tax credit studies that are part of  
7 the record here in this case, but here's the method. We  
8 took Exhibit 32 -- actually, it was a larger exhibit  
9 before Exhibit 32 -- and we took the first pass at it by  
10 taking out -- by doing employee surveys to take out  
11 nonqualified employees, nonqualified projects, and  
12 nonqualified phases. Then we re-ran the reports, and  
13 that's what you have for Exhibit 32; re-running the report  
14 to take out additional nonqualified activities and funded  
15 research. Then we went onto Step 3, and we basically come  
16 in and review the remaining results to determine that  
17 there are records available that support the projects,  
18 phases, and activities that remain after making those  
19 cuts.

20 So it looks like this. If you can see the  
21 screen -- I know it's probably small -- but the task of  
22 computing an R&D tax credit using the project method is to  
23 start with all wages and all time. And so that's the  
24 outer ring, which is noted as a six, and working your way  
25 back until you get to the -- to what's left, which is the

1 research; in theory, the qualified research. And so if  
2 you were to look at Exhibit 32, that's exactly what we  
3 did.

4 So on this slide we have a step-by-step  
5 spreadsheets that were actually used to compute the  
6 credits. And so it's noting on this slide that the study  
7 provider is taking out the nonqualified projects. They're  
8 going through and trying to take out the nonqualified  
9 phases and the none non-qualifying employees. When they  
10 get to Step 2, they resort the data, and this is data  
11 provided to the FTB. They resort the data by employee.  
12 And since there's only 30 to 40 employees, they're able to  
13 go employee by employee and further reduce it for  
14 non-qualifying projects and non-qualifying phases. And  
15 they can come in and do a funded research analysis where  
16 they take off hours. And what you can see here on the  
17 example that's on the screen, you see that the paid time  
18 off has zero hours taken next to it. There's a zero.

19 And you can also see the hourly work, which is  
20 called consulting. And at the bottom you can see AS for  
21 additional services, and you can see those are zero. And  
22 so why that's important is because that's showing that  
23 those hours are being taken out with all that's left is  
24 the design development, the bidding negotiation, and a  
25 couple of other phases here. Now, these phases -- again,

1 we'll go through another reduction in a minute. But you  
2 see right now, where we're at for this particular employee  
3 for this particular year, you can see they worked a total  
4 of 984 hours that year. And remaining they have 247 hours  
5 that remained after making the cuts to identify the  
6 research activities. That leaves a 25 percent allocation  
7 for that one employee for that one year.

8 So the study provider put that on a work paper.  
9 It has the wages on it to identify the wage GREs. That's  
10 in exhibit -- I don't know what it translates to, but  
11 it's -- it was Exhibit Q on page 27. And from there, the  
12 study provider will come in and actually make additional  
13 cuts based on a review of the taxpayer's business records.  
14 And so this is an example of Exhibit 12. This is an  
15 example of one of the records. There's a typo on this  
16 demonstrative. It should be "Brick & Machine" for the  
17 project name. But this is the type of records that we're  
18 looking for that's verifying that they are doing qualified  
19 research for the design phase, and it's dated around the  
20 same period of time that's relevant to this case.

21 Once that step is done, you get back to  
22 Exhibit Q. Again, I apologize. That's been renumbered.  
23 But you get to the final chart that's in the study  
24 research tax credit stud study, and it ties to the number  
25 that's on the individual -- or the business income tax

1 return for that year. And so the resulting percentage is  
2 in the third to right column for each employee. And so  
3 what you have is by using that method, you are able to  
4 have the employee by job title, by the amount, total wages  
5 by their W-2, times the number of hours to get to the  
6 percentage that's qualified, and you just multiply those  
7 across and it's simple math to get to the amount that's  
8 reported on the return.

9 Now, in addition to the documents that are in  
10 evidence that includes the study reports, which are quite  
11 detailed. It also includes a witness statement from  
12 Rebecca Branch. So that's Exhibit 39. Rebecca is the  
13 study provider's employee that did the study. She goes  
14 through in her witness statement and explains this  
15 process. But, in addition, you have witness statements  
16 from Trevor Abramson and Douglas Teiger that go into great  
17 detail about the process and the projects as well. Now,  
18 it's important to pause and think about how have the  
19 courts received this IRS project method? And the short  
20 version is, there is not a single case that has been  
21 reported where a taxpayer has applied the project method,  
22 and they have shrunken back their research to the  
23 qualified research using the process set out in the IRS  
24 briefing paper.

25 There's not a single court case where taxpayers

1 have lost or not been allowed credits when they have used  
2 that method. And, in fact, the reason why is largely  
3 because the IRS does not challenge taxpayers who use that  
4 method because that is the proven method. So instead,  
5 those usually get a pass on audit.

6 Now, I want to stop and look at the FTB's method.  
7 So this is a summary, again, of Exhibit 32. And also  
8 you'll find the same summary or similar summary in  
9 Exhibit 1, which is the FTB's report. But take, for  
10 example, 2013. There were is 112 projects. Using the  
11 IRS's project approach method, the taxpayers got their  
12 projects down to 39 non-qualifying projects. Now, the  
13 bottom row on this demonstrative should say five projects.  
14 There was one very small project in 2013 that the FTB  
15 reviewed, and it was the Culver Platform Project. So  
16 technically, the bottom row should indicate that there  
17 five projects that the FTB reviewed. And so you can see  
18 the FTB made its conclusions on audit and then the myriad  
19 of arguments it's making on appeal for the first time were  
20 based on 5 projects out of 762.

21 So the FTB didn't even look at one fraction of  
22 1 percent. And based on that, it was enough to generate  
23 the pages and pages of new issues that it raised during  
24 the appeal. Now, if you look at how the FTB it reviewed  
25 the credits, again, we believe they have the burden on

1     these issues. Now, if you look at how they reviewed them,  
2     though, the method that they used is one of the methods  
3     described by the IRS as being unacceptable. Basically,  
4     the FTB is coming in on a cost center approach, and we  
5     didn't use that method because, again, it's not -- it's  
6     not a valid method when you have project records.

7             So what you have on the screen is, unlike the  
8     taxpayer who did the three-step method as outlined in the  
9     IRS briefing paper, the FTB's method for examining these  
10    was to look at five projects. And instead of looking at  
11    the original data, it discarded that and looked at the  
12    summary report for things that it could cherry pick. And,  
13    so, for example, you'll see that in its briefing the FTB  
14    complains about the project records. And one of the  
15    complaints, for example, is it says, hey, the  
16    description -- the written description on some of the  
17    projects is blank. And there's a reason for that.

18            The reason is because the FTB auditor sorted and  
19    resorted the data. And so if you had sorted it  
20    chronologically, you would see that the employee would,  
21    for example, have a design phase where they're talking  
22    about a model and then you would have some meetings. And  
23    then under that, you would have a new model and it would  
24    say something in the activity, like, new model. Well,  
25    because the FTB resorted and cut and paste and did

1       whatever they did to the data, they conclude that an entry  
2       that just says meeting doesn't indicate that that's  
3       qualifying time, even though it indicates that it's in the  
4       schematic design phase, and even though if they had sorted  
5       the data chronologically, they would see how that meeting  
6       actually fits into the research process.

7               But because they sorted it that way, in their  
8       brief for the first time, they complain and say well,  
9       look, some of the entries have this issue. Well, we don't  
10      believe it does. In their brief for the first time, they  
11      also complain about some of the entries on the description  
12      are blank. Again, these are not many, very few. I think  
13      they pointed out six entries out of thousands. But of  
14      those entries, if you look at them -- again, if you were  
15      to sort them chronologically, they actually make sense.  
16      It's because the FTB didn't copy down the entry above.  
17      And so, again, we can't help how the FTB sorted it. We  
18      weren't presented with this on audit. We could have  
19      corrected for them before they spent all the time on their  
20      brief writing about it.

21              But since they raised it for the first time in  
22      their brief, we weren't given the opportunity to do that.  
23      Now, the FTB also apparently doesn't seem to realize that  
24      the exhibits that they're looking at were the second  
25      version that was shinnied down to exclude several phases.



1 But you can see that in the title of the document. It's.  
2 "ATA Billing with Selected Phase Only." And so what  
3 you're looking at there is a report that's generated that  
4 already makes certain cuts. So, again, these are the  
5 phases that survive the cuts that are in the exhibit and  
6 what we're taking credit for. But the phases that the FTB  
7 doesn't see are the ones that they're largely arguing  
8 about and making points on in their brief that were not  
9 even included in the R&D study.

10 So it's helpful to pause and look at the summary.  
11 So what you see on the screen here, this is a snippet from  
12 Exhibit 1, and you can see how it has 2016 and 2017 for  
13 one project. And so this is the entire time for 2016 and  
14 2017, for example, that the taxpayer picked up for this  
15 one project, and it's the Brick & Machine Project. Trevor  
16 Abramson is going to explain this project in a little bit  
17 in his presentation. But you can see what the FTB's  
18 report says here. It shows that for the first year of the  
19 project in 2016 the taxpayer picked up three phases and  
20 time only from three phases.

21 And as you can see from 2016 to 2017, you can see  
22 that phase one lasted 1,200 hours in 2016. And then in  
23 the second year, 2017, it went down to 40 hours for phase  
24 one. The reason why it did that is because that phase  
25 ended. Again, this is a multiyear project. I believe it

1 ran all the way through 2020. So it went even beyond the  
2 audit years, I believe, for this audit. And so what the  
3 FTB looks at, it says, well, hey, I'm only going to look  
4 at it on a year-by-year basis. And by doing that, look,  
5 you're taking 74 percent of your time as qualified. And  
6 that's not true because these numbers don't count the  
7 things that were already excluded.

8 And also, if you look at how the chart on the  
9 right, when the research activities in the first and  
10 second phase kind of plateau and end, that lines up with  
11 what we have here on the screen where you have the first  
12 phase starting and ending, the second phase starting and  
13 starting to end, and then moving onto the next phase. So  
14 if the FTB able to snapshot and just look at the plateau  
15 of research as depicted in this chart, you could see how  
16 it might believe that there's a lot of hours taken, but  
17 that's because it didn't look to the next year or to the  
18 next period.

19 Now, you don't have to take my word for this  
20 either because the FTB has actually put together a  
21 summary, and this is a depiction of it. But what you have  
22 here is you basically have Exhibit X, which is the FTB's  
23 exhibit. And you can see that looking at their summary,  
24 what they have done is they have basically taken the  
25 total, which is not the real total. That's the total on

1 Step 2 from after the taxpayer made cuts already. And  
2 then they're saying that the taxpayer, for example on the  
3 one that's highlighted, is taking what amounts to  
4 96 percent of that much phase for its credit.

5 Again, that's not true because that phase  
6 stopped -- started and stopped probably in that year. But  
7 that's in the data. But you can see by not looking at  
8 across multiple years, they're making arguments that don't  
9 really apply here. Now, I want to pause to talk about the  
10 court cases, and there are a quite a few court cases for  
11 the research tax credit. So I'm not even going to address  
12 the ones that are helpful for the taxpayers, where the  
13 taxpayers prevailed. I'm just going to focus on the  
14 couple that the FTB, not only attached to its case here,  
15 but that it thinks are relevant.

16 So I'd like to start with the Betz case. That's  
17 B-e-t-z versus Commissioner, TC memo 2023-84. Now, the  
18 Betz case involved a business component that was an air  
19 pollution system. And the taxpayer was -- if you still  
20 can see my screen, it's the -- they were a manufacturer  
21 and a designer. So unlike do manufacturing only does  
22 design work, this taxpayer in Betz did both. They did  
23 design and manufacturing. And in the case, the court  
24 explains that the research phase for the design work in  
25 that case was only one phase because they had a bid and

1     proposal phase that was basically all the entire design  
2     was done in that one phase. So they had a very short  
3     design phase, and a very long manufacturing phase.

4             And so the credit in that case, the taxpayer took  
5     credit for both phases. They tried to take credit for the  
6     manufacturing phase, and they tried to credit for the  
7     design phase. The court notes that the taxpayer in that  
8     case did not use a time tracking system for its employees'  
9     activities. It notes that the taxpayer had to estimate  
10    their time-performing qualified services, that they only  
11    relied on testimony and testimony alone, and the court  
12    notes that that testimony was vague. So the taxpayer, as  
13    noted in the court, tried to qualify the project as a  
14    whole. And that's a quote, "Project as a whole."

15            So you can see, not only did the taxpayer in Betz  
16    not have the manufacturing -- not exclude the  
17    manufacturing, they also didn't shrink back to the  
18    research activity for the design efforts. So the result  
19    is, naturally, that they weren't allowed credits. And you  
20    can see why because they're taking credit for something  
21    that they don't have records for, and they weren't able to  
22    shrink back.

23            Now, that case the FTB asserts is harmful for the  
24    taxpayers in this case when it is not. It actually  
25    demonstrates quite clearly why the taxpayers are entitled

1 to the credits in this case. Again, we don't do  
2 manufacturing. We don't have any of that time, and we  
3 shrunk back to the qualified time on the design phase.

4 The second case that the FTB cites is the Little  
5 Sandy Coal case. Now, this is a case that went up to the  
6 Seventh Circuit. So the FTB has attached both the Tax  
7 Court case and then the Seventh Circuit, the appeals case.  
8 It's very similar to the Betz case that we just discussed.  
9 So in the Little Sandy Coal case, the taxpayer was  
10 designing large boats. So it was vessels or boats. And  
11 like the Betz case, the taxpayer in this case was a  
12 manufacturer. And so it had manufacturing time, and it  
13 had design time.

14 In looking at the credit itself, the records,  
15 like the Betz case the taxpayer did not have records.  
16 They did not have timesheet records or data. And so  
17 because of that they were not only not able to separate  
18 out their manufacturing time from their design time, they  
19 were not able to shrink back to the qualified time on the  
20 design to get to the qualified research activities. The  
21 court notes this in the opinion and says that the taxpayer  
22 in that case took an all or nothing approach. And because  
23 the court could not shrink back, the taxpayer was not able  
24 to get its credits in that case.

25 When that went to the Seventh Circuit, the

1 taxpayer argued that the Tax Court erred by not applying  
2 the four-part test to the business component. And the  
3 Appellate Court, the Seventh Circuit, said, well, yes, the  
4 Tax Court was correct in applying the rules, the four-part  
5 rules to the entire project only because the taxpayer  
6 didn't provide the records to allow the court -- the Tax  
7 Court to do a shrink back. And, again, we did that in  
8 this case. So the Little Sandy Coal case stands for the  
9 proposition that the four-part test is applied to the  
10 shrunken-back business component, not to the project, but  
11 to the shrunken-back business component.

12 So the four-part -- we'll get to in a minute --  
13 includes one of the tests, which is a process of  
14 experimentation test. That has an substantially all rule.  
15 That rule is applied at the shrunken-back business  
16 component, and that's what the Little Sandy Coal case  
17 stands for. Now, in our case we always will meet that  
18 because we're only doing design work, and we shrunk back.  
19 So substantially all fraction that the court gets into in  
20 Little Sandy Goal is easily met in this case because it's  
21 100 percent. We were able to shrink back to just the  
22 qualifying time.

23 Now, another case that the FTB cites, they didn't  
24 attach it, but it's the Leon Max versus Commissioner case.  
25 It is TC Memo 2021-37. This case is cited by the FTB, and

1 the business component in this case is clothing garments.  
2 So it's a very similar case to the Swat-Fame case that the  
3 Office of Tax Appeals had previously considered. But  
4 looking at this case, the taxpayer in that case actually  
5 designed clothing garments. And like the other cases I  
6 described, they did not have any records to support what  
7 was manufacturing and what was designed. And within the  
8 design category, they didn't have any records to shrink  
9 back to identify what was qualified.

10 So just like the other taxpayers, the court said  
11 that they don't qualify. Now, this court case focused on  
12 the aesthetic parts of the taxpayer's work. And what the  
13 court was saying is, hey, there is this exclusion for  
14 aesthetics, and because you have no records to shrink  
15 back, we can't tell what's aesthetic and what's not. So  
16 unlike the records we have in this case, they didn't have  
17 them. Now, interestingly, in this court case the Leon Max  
18 case, the court actually puts in something very helpful, I  
19 think, that's -- it notes that had the taxpayer shrunken  
20 back to, for example -- and it uses this. It says, "Well,  
21 if you had studied the DNA of goats to determine what the  
22 best cashmere" -- "what goat produces the best cashmere  
23 sweater, that actually could qualify."

24 And so, apparently, there was testimony on this,  
25 and the taxpayer did that type of research in the court

1 case. But the court is noting that the taxpayer didn't  
2 shrink back to that. Instead, they included the entire  
3 manufacturing time. They included the design time. They  
4 didn't shrink back to the research, which would have been  
5 just, for example, on that project, perhaps the DNA study  
6 for goats. But because they didn't do that, the court  
7 notes that they didn't get a credit. But, again, that's  
8 not really what we have here.

9 Now, I want to shift gears, and I want to talk  
10 about the four-part test. And I'm going to stop sharing  
11 my screen, if I can. Okay. I think I'm back.

12 So I want to talk about the four-part test. So  
13 Trevor Abramson is going to come up next. And I'm not  
14 going to do this justice, but I'm going to try to take a  
15 project -- he will do it much better than me. But I'm  
16 going to take a project. I'm going to give you an  
17 overview of it, and I'm going to explain how it meets the  
18 four-part test. And then Trevor will come on next, and  
19 he'll go through in more detail.

20 So I'm going to start with the VBS Gym sample.  
21 It's one of the sample projects. And you can find this in  
22 Exhibits 50 and 52. So in Exhibit 50, you see the kind of  
23 three-dimensional modeling that was done and different  
24 variations of that. And then in 52 you can kind of see  
25 the end result. Okay. So if you were to look at this



1 business component -- what it is, is it's a roofing  
2 system. And so my description of the project is this.  
3 Abramson Architects was presented with a project that  
4 required a large building that's going to be a gymnasium,  
5 a very large gymnasium.

6 The building was to have only three sides. One  
7 side was to be entirely open, so open to the world. It  
8 could open up. So one side of the building provided no  
9 structural support. In addition, the building couldn't  
10 have any support internal to the building because it was  
11 going to be used as a gymnasium. So you have no internal  
12 support. You have one -- you know, naturally the  
13 perimeter of the building, the four walls would be the  
14 natural support for the roof, but in this case they only  
15 had three walls because one was basically open. In  
16 addition to that, the typical roofing structures would not  
17 work. And there's a number of reasons, but there's no way  
18 to hold them up.

19 The other challenge is typically to meet energy  
20 efficiency, you have to put a large HVAC system, heating  
21 and cooling, on a roof. And the closer you can get that  
22 to where it's coming out, that actually reduces your  
23 energy use. Well, this project had a very high energy  
24 requirement. And so there was no solution that was able  
25 to come up with a roofing system that number one, was

1 structurally sound but also it didn't cause it to fail the  
2 energy efficiency.

3 So you can see there's a jigsaw puzzle here that  
4 none of the known solutions could actually solve. And so,  
5 for example, you can't just cover it over in glass because  
6 there's objects flying in the gymnasium that would break  
7 it. You can't put anything like a flat metal roof because  
8 that limits the lighting, and you have to have high  
9 lighting for the gym for the intended use. So you can see  
10 you have this kind of nothing works. There's nothing that  
11 actually works to be able to accomplish this. And if you  
12 look at the 3D modeling, you will see that the end result  
13 was this kind of highly innovative roofing system that's  
14 new to the world. It doesn't exist.

15 And if you look at it, it has -- again, I'm not  
16 an architect so bear me. But it has basically steeples  
17 that are positioned in certain ways to let light in or not  
18 in. So that way it's reducing the energy consumption  
19 while also letting light in. But at the same time, the  
20 structural trust components allow it to span that entire  
21 area without actually having the standard I-beams that you  
22 see in kind of, you know, a warehouse. Highly unique.  
23 It's structurally sound.

24 So they proved it out with mathematical modeling  
25 to prove out the structural integrity of it. They did

1 lighting and energy testing to make sure that it's going  
2 the -- the final design would actually meet those tests.  
3 Some of the designs did not meet the test, and you can see  
4 that in the modeling. They actually had to go back and  
5 redesign the roofing system for different ways to actually  
6 make -- to come up with the final design based on the  
7 calculations and the model.

8 So that's my overview of the project. Let me  
9 tell you why I think it meets the four-part test. So the  
10 first test is the 174 test. And what this test asks is,  
11 does the taxpayer have the information available at the  
12 outset for the appropriate design? So in that example the  
13 normal methods that would have been known to an architect  
14 or engineer would not apply here. Clearly, that's the  
15 whole nature of the challenge for this project is they did  
16 not have the information. I just note that if the  
17 taxpayer or the client actually knew how to design this  
18 innovative new-to-the-world roofing system, they wouldn't  
19 have paid Abramson Architect the money that they paid them  
20 to design it. And Abramson would not have recorded its  
21 time in Exhibit 32 and all the phases to design that  
22 roofing system if it was already known. That doesn't even  
23 make sense.

24 But the FTB is arguing that. They are arguing  
25 that, oh, that's already known even though you have to do

1 the calculations and mathematical modeling to actually get  
2 to the design to figure out it doesn't work, to redesign  
3 it again only to find out that doesn't work. You have to  
4 do this iterative process. So I believe the first test,  
5 the 174 test, is met. There's an uncertainty as to the  
6 design the taxpayer did. It's a technical uncertainty.  
7 They didn't have the information at the time to answer  
8 that uncertainty. They went through a process to do so.

9 Now, the second test. The second test is that  
10 the taxpayer has to discover -- intend to discover  
11 technological information. This test is also met. So the  
12 rule says that information is technological in nature, if  
13 it is basically discovering design elements. And so  
14 things that are needed, for example in this case, with  
15 this project, they're discovering the energy efficiency  
16 and structural integrity of a roofing building system.  
17 And you actually have to do the models and math and see  
18 how they work together to figure out is my design actually  
19 going to work and meet the criteria, not hurt people and  
20 be safe, and meet all the intended use. And so they did  
21 that. That's the technological information. It meets  
22 that test. The FTB argues that it doesn't. It hasn't  
23 really provided any basis or explanation why.

24 The next test is it has to be for a business  
25 component. And, again, we've addressed that. That was

1       conceded by the auditor and then raised by the FTB as a  
2       new issue on appeal. Again, the business component is the  
3       design of the roofing system. That's where the taxpayers  
4       in Exhibit 32 are putting this their time in. So they are  
5       recording their time in the design phases to design and  
6       develop that roofing system for this particular project.  
7       So we think that test is met.

8               The next one is the process of experimentation.  
9       This is the final test of the four-part tests. This test  
10      looks at whether the taxpayer went through and systematic  
11      trial and error. That's the way the regulations describe  
12      the process of experimentation, is a systematic trial and  
13      error process. And so, usually, it's akin to the  
14      scientific method. And so you're starting kind of with a  
15      hypothesis of I think I can design that to I can design  
16      it. I'm going to test, you know, gather data. I'm going  
17      to do some testing, and then I'm going to discard  
18      different alternatives to get to the final results.

19             Now, Exhibit 32 actually sets out the phases. It  
20      sets them out. There's nothing clearer than something  
21      that says here are the individual steps, and that's a  
22      systematic process. It sets out every step in order.  
23      We've provided descriptions in our brief and in the  
24      project documents and the witness statements and Trevor is  
25      going to get into it more. We've provided evidence that

1 shows that process and each step. So that is a systematic  
2 trial and error process that is -- meets the definition of  
3 a process of experimentation. Okay. So that's the  
4 four-part.

5 Now, there are two exclusions that are, again,  
6 raised by the FTB as new issues here on appeal. But the  
7 two issues are the funded research exception and then the  
8 arts, social sciences, and humanities exception. So I'll  
9 do those real quick, and then I'll turn it over to Trevor.

10 Now, on the -- I've already kind of explained the  
11 exception for the arts, humanities, and social sciences.  
12 We didn't pick up time for fancy drawings and renderings.  
13 That would not have been included in Exhibit 32. We  
14 explained that. Those were excluded. We've shown that  
15 through the phases that were picked up. And so I don't  
16 think I have to go into that further.

17 I will also note in our brief the FTB is wanting  
18 to apply copyright law here. The Lockheed Martin court  
19 case is noted in our brief. The courts have said that IP  
20 law, intellectual property, like, copyright law, doesn't  
21 apply to the R&D credit. And it even notes the reason  
22 because intellectual property law has slightly different  
23 rationales. It's to protect property. So it's from third  
24 parties how you define and protect property. That's a  
25 different set of purposes than what the R&D credit is

1 getting out.

2 So their references to copyright law, not only  
3 did we not include copyright -- copyright is for drawings  
4 by the way. It protects written thing. So we're not  
5 really getting into that because it doesn't -- we've not  
6 only excluded the drawings in the way we calculated the  
7 credit, but on top of that the courts have said that  
8 copyright law does not apply. They expressly said that.  
9 But, again, you can find that in our brief.

10 Now, the other exception is the funded research  
11 exception. And this exception really applies to folks  
12 that are taking R&D credits when they're being paid by  
13 another party, so like in an architect and engineering  
14 scenario. There are several court cases on point on this,  
15 but the code just says that research doesn't include  
16 funded research. And then the regulation set out a  
17 two-step -- two tests, if you will, to determine whether  
18 research is funded.

19 And I've got a demonstrative that I'd like to  
20 share with you on this to help explain the funded research  
21 exception. So I'm going to try to share my screen again.  
22 One second. I have my screen shared. Are you able to see  
23 my screen?

24 JUDGE LONG: Yes, we are. Thank you.

25 MR. MITCHELL: Oh, thank you.

1           So these are the two tests for funded research.  
2       And so the first test looks at the financial risk for the  
3       research, and the second test asks whether the researcher  
4       retains substantial rights in the research results. So  
5       I'll start with the first test. By the way, the courts  
6       have said on this funded research exclusion is to be  
7       considered by only looking at the contracts. And so for  
8       the five projects that we have that the contracts are in,  
9       are in the exhibits.

10           And so, again, this is a contract analysis. And  
11       so when we start with the first test, the financial risk  
12       for research, what we're looking at there is it starts  
13       with an analysis of the payment terms. And so there's two  
14       kind of categories, if you will, of contracts for payment  
15       terms. There's fixed price contracts, which where a  
16       taxpayer, for example, is paid a fixed price. And there's  
17       also hourly or cost contracts where there are cost  
18       reimbursement. And so in this particular case, almost  
19       without exception, the taxpayer has only taken credit for  
20       fixed price contracts. Now, there's different court cases  
21       out there that address fixed price contracts and some that  
22       address non-fixed price. But, generally, as we'll talk  
23       about, almost without exclusion the fixed price contracts  
24       had been found to be qualifying, meaning they are not  
25       subject to this limitation.



1           And so in Exhibit 32, as we went through the  
2 records and showed you how we took out items, the R&D  
3 study provider specifically went through and did a funded  
4 research analysis to take out the non-fixed price hours.  
5 So we didn't even include those in the R&D tax credit  
6 study. And, again, because this was an issue raised for  
7 the first time, really, on appeal, we weren't given all  
8 that much time to explain this and point it out because it  
9 was during the appeals process. Now, we did present it  
10 initially when the Populous Holdings case came out  
11 because -- as we'll get to in a minute -- that case is  
12 very similar to the case -- to the work that's done in our  
13 case. It's a very similarly situated taxpayer, and they  
14 were allowed their credits in full. But we'll come back  
15 to that.

16           So looking at what we did, on this slide on the  
17 demonstrative, you can see that in 2016, for example, we  
18 only picked up in the R&D credit 1,702 hours of additional  
19 services. That's out of about 45,000 hours worked by all  
20 the employees in 2016. Now, it's de minimis. Not only  
21 are the hours that are non-fixed price de minimis, you can  
22 find the computation for them in Exhibit 1, which is the  
23 FTB's AIPS report. It actually summarizes them. The  
24 accounting records, the time records, they capture these  
25 with the star AS for additional services.

1           And so of the few hours that were included, it  
2       was because the taxpayer actually went through all 130 --  
3       depending on the year -- number of projects. And for  
4       those that were qualified, they actually went through and  
5       identified a few of them, not many, that were hourly  
6       contracts and picked those up. Now, again, it's de  
7       minimis. It doesn't really budge the amount of the R&D  
8       credit, and I don't think the FTB realized that because it  
9       spent pages and pages in its brief instead of just saying  
10      that, hey, I'm just going to exclude the hourly amounts  
11      which don't even budge the credit, and which are the  
12      numbers set out. They have a method. They have the math  
13      to do so. It's in their report in Exhibit 1. Instead of  
14      doing that, they say, oh, you get no credit.

15           And I want to show you the contract terms that  
16      show you that in a minute. But looking at the slide here,  
17      the two court cases that deal with fixed-price contracts,  
18      you have the are the contracts. You have the Geosyntec  
19      case. It's cited here as a Southern District of Ohio  
20      District Court. It actually went up to the Appellate  
21      level, I believe the Second Circuit. And the Second  
22      Circuit confirmed that fixed-price contracts are  
23      inherently risky for the person doing the research. And  
24      so they say they put the maximum economic risk on the  
25      taxpayer that's doing the research.

1           So the same holding was found the Tax Court in  
2   Populous Holdings case. He came in and looked at it and  
3   said that the fixed price contracts are inherently risky.  
4   If you look at the work in both of these cases, Geosyntec  
5   and Populous Holdings, as I mentioned earlier, those cases  
6   are for taxpayers who are doing very similar work to the  
7   taxpayer in this case. And we point out in our brief that  
8   the FTB has not even explained why those taxpayers were  
9   allowed their credits for their fixed-priced contracts  
10   when the FTB is not allowing the credits here. There's  
11   been no response to that.

12           Now, looking at the brief, the FTB points out the  
13   Brick & Machine Project. And so since they pointed it out  
14   for this issue, I wanted to show you the contract terms to  
15   show exactly why this contract is not subject to this  
16   exclusion. So on this slide I'm noting paragraph 12.2.  
17   It's on page 20 of the contract. And, again, this  
18   contract is in evidence in this case. That paragraph says  
19   that the taxpayer is to pay -- be paid a fixed fee of  
20   \$940,000. For that \$940,000, it's only for their basic  
21   services. The contract, Article 4, says what basic  
22   services are. It identifies six phases. So I have them  
23   highlighted on the screen, but it includes schematic  
24   design, design development, et cetera.

25           Now, at the bottom of the screen I have a snippet

1 from the auditor's report for the same project showing the  
2 phases that were picked up for that project for this  
3 particular year. And so you can see from the -- I hope  
4 you can see. It's kind of small. But it's showing that  
5 the taxpayer only picked up the phases which are schematic  
6 design, design development, and contract documents. Those  
7 are all provisions under the contract that are basic  
8 services. It says that in Article 4. So instead of  
9 looking at that, the FTB takes the position of well, wait.  
10 If you look at the contract, there's a provision on page  
11 21 that says additional services, and it says those will  
12 be charged hourly.

13 Well, again, we didn't pick up any hours for  
14 additional services for this contract or this project. We  
15 replied that way in our brief, and would have done so in  
16 audit had they raised or pointed out this issue on audit,  
17 but the FTB didn't do that. So instead, they wrote  
18 several pages not realizing that we didn't even pick up  
19 credit for what they are arguing about. And, in addition,  
20 if they are, on the very few that have additional services  
21 that are hourly, it's de minimis. And, actually, the math  
22 is there for them to have excluded those specifically if  
23 they thought they were at issue. The problem is they  
24 didn't actually look at any of the contracts well past  
25 this to even be able to do that.

1           So, again, we're back to they are raising an  
2           argument on appeal, and they don't really know because  
3           they haven't really looked at the records. They don't  
4           understand them. And now we're having to defend this  
5           position when we could have actually just explained it to  
6           them. Now, that's the first test.

7           The second test for this is retention of  
8           substantial rights. So generally with this rule, this  
9           rule looks at between the researcher and their client.  
10          Does the researcher retain the right to use the research  
11          results, for example, in the future. So it's a  
12          hypothetical question that when you review a contract you  
13          have to look at, well, okay if the taxpayer was going to  
14          go design the same or similar roofing system for somebody  
15          in the future, could they use what they learn from the  
16          research in that future project? And there are a couple  
17          of court cases on point, the Lockheed Martin court case.  
18          It's cited in our brief as the lead case. And what it  
19          basically says is that taxpayers retain research, unless  
20          their contract terms give it away.

21          And so one way to give it away is to basically to  
22          say that the other party, the client, has all rights to  
23          all -- anything known that's learned during the project.  
24          And sometimes you'll see that they -- the language will  
25          also say for the taxpayers that the taxpayer has to pay a

1 royalty to be able to use what they learned in a future  
2 project. Well, we don't have that in this case. And so I  
3 have an example one here from the Platform contract.  
4 Again, this contract is in evidence in this case. But if  
5 you look at the Platform contract, you'll see Section 7.2,  
6 which says that the researcher, the architect, shall  
7 retain all common law, statutory, and other reserved  
8 rights.

9           So there you have it. The taxpayer is reserving  
10 all rights. That means that they retain substantial  
11 rights in the research. If you look at Section 7.3 of the  
12 contract, it goes on to say that there's a non-exclusive  
13 license for the other party to use the instruments of  
14 service. So the other party actually has limited rights.  
15 So not only do we retain substantial rights, which is  
16 entirely all the rights, the taxpayer in this case retains  
17 them all. But they only gave away a non-exclusive  
18 license. And so under the Lockheed Martin case, that  
19 clearly shows that the taxpayers are not subject to the  
20 funded research rule for this test.

21           Since we're looking at that contract, I went  
22 ahead -- and I'm jumping back to the first funded research  
23 test. I just note that if you were to look at Article 3 of  
24 the Platform contract, it will have the same definition of  
25 additional services. And if you look at 11.5, it'll say

1 similar to what we looked at earlier, what is basic  
2 services, and it'll go through and define what basic  
3 services are. So, again, This contract meets both of the  
4 tests.

5 Now, on the screen I have the other contract  
6 terms for the other sample projects. They're very  
7 similar. The FTB, again, is going to come in and point  
8 out various contract provisions that it thinks are  
9 relevant. But at the end of the day, these are  
10 fixed-priced contracts. That's all that was picked up was  
11 primarily the fixed-price hours, and then there's no  
12 rights issue because they retain the rights to use their  
13 research results.

14 I'm going to try stop shearing my screen now.  
15 Okay.

16 So that is the funded research exception. I  
17 think those are most of the arguments that the FTB has  
18 raised. Again, it's raising a number of them.

19 I'd like to turn it over to Trevor Abramson to  
20 explain the details of the other sample projects. He can  
21 do it much more justice than I can.

22 Mr. Abramson, are you here?

23 MR. ABRAMSON: Sorry. I was on mute. Thank you  
24 very much, Kreig and Judges and FTB. Thank you for the  
25 opportunity for me to actually speak after five years.

1       It's been a long time coming.

2               I do agree with how we qualify the research. I  
3 agree with how we shrunk-back the data to use qualified  
4 time only. And my super anal personality, which trickles  
5 down to through the whole firm is reflected in the great  
6 records that we keep. It's very, very important to us and  
7 to everything that we do. We have five projects in the  
8 sampling, and I'm going tell you about just two. I'm  
9 going to talk about two of those in order to keep time a  
10 little more brief.

11              And I'll start with the Brick & Machine and  
12 explain how it qualifies. This project involved designing  
13 an office building that had no space for parking. It had  
14 drainage issues that seemed unsurmountable and was  
15 structurally unsound and not energy efficient which needed  
16 to be. We had -- we were uncertain as to whether we could  
17 design the building and building system so that it would  
18 be structurally sound, energy efficient, constructible,  
19 and would meet various code requirements.

20              I don't know the information for design at the  
21 outset. When we sign a contract, typically, we do not do  
22 a detailed bid and investigation into the all the  
23 parameters for the design. We sign a fixed-fee contract,  
24 and we know we have to deliver a building, but don't know  
25 all the problems that are going to occur, all the items we



1     need to solve. Once we start the project, in the case of  
2     the Brick & Machine, we discovered information that  
3     created uncertainties that needed to be resolved. And  
4     this goes beyond the standard architectural agreement.

5             In our qualified Brick & Machine qualified data,  
6     I'm not -- we did not time put time into design the  
7     elevators and to design the waterproofing and to design  
8     the aesthetic of the exterior of the building. We just  
9     shrunk it back to the data to -- the data that's pertinent  
10    to the uncertainties. And I'll get back to the Brick &  
11    Machine. This site did not have any space for the  
12    parking, and the intended use did not accommodate a  
13    structure that could house a required number of vehicles,  
14    which the code said it must have. Given that there were  
15    in feasible spaces -- off-site space for parking, the  
16    parking had to go underground. But underground options  
17    did not seem feasible given the load of the adjacent  
18    buildings and the high-water table in the area and the  
19    common mitigation solutions for pumping out water, which  
20    would not be energy efficient.

21            We didn't have all this information at the  
22    outset. When we get to do a final design, we measured the  
23    results. I do the design. I do the modeling. I do the  
24    calculations; some fail, some don't. But when we get to a  
25    final design, it's measured against by the code. The code

1 does not give me the design. If that were the case, every  
2 building in the country would look alike. We don't design  
3 to the code. Our design often exceeds the code by far.  
4 And by the way, there are many conflicting codes. Most  
5 codes themselves are merely a way to judge the output of  
6 my design. They're not instructions to create my design.

7 Technical uncertainties that we find on projects  
8 of this scale will never be found in the code. The code  
9 is a test. It's like a great key of the design to see if  
10 it meets certain minimum criteria after the fact. During  
11 the design process, we hypothesized -- I hypothesized that  
12 I can design in a certain way. I gather the data. I test  
13 the data. I create models that are just -- that are not  
14 just applied principles. That is me using designs to  
15 resolve uncertainties, to research, to figure out unknown  
16 solutions. In the case of the Brick & Machine, we devised  
17 several alternative to resolve these uncertainties. These  
18 design alternatives include designs to achieve the most  
19 energy efficient performance possible while resolving all  
20 other uncertainties.

21 A design alternative considered underground  
22 parking options, parking configurations, traffic flow,  
23 slope. Our calculations are a three-dimensional modeling  
24 showed the three levels of parking underground would be  
25 needed to accommodate the number of parking spaces

1 required by code, but we discovered we had a problem.  
2 Underground parking, yeah, easy. Many buildings have  
3 underground parking. But this building had a very  
4 high-water table. So you can't just ordinarily put it  
5 underground without solving for a whole lot of  
6 uncertainties.

7 The high-water table led us to consider several  
8 alternative designs and employed numerous drainage  
9 options. The drainage options were not adequate as most  
10 of them caused the project to fail in its energy  
11 efficiency requirements as they required a huge amount of  
12 electricity to transport and pump the water. One thing is  
13 influencing another. It's not just a simple straight line  
14 approach here. We considered alternative designs that  
15 included several above ground energy solutions to mitigate  
16 some of the drainage to stop the water from going  
17 underground, and stop the water from underground from  
18 coming up while also reducing energy consumption for the  
19 building given the energy used needed for the drainage.

20 These design alternatives included exterior  
21 screens, strategically designed courtyard to allow air to  
22 flow through keeping the building cooler, and rooftop  
23 gardens along with the design and layout of underground  
24 parking and drainage systems. After several alternative  
25 designs, we came up with a concept of using a large

1 waterproof membrane for the entire garage combined in it  
2 with a unique drainage system that would allow the garage  
3 to function much like a large bathtub put into the ground.  
4 That, together with a unique flooring system to provide  
5 structural support for the adjacent buildings would offset  
6 energy consumed by the garage draining systems so that we  
7 could comply with energy efficiency requirements of the  
8 project.

9 Our calculations and modeling eventually proved  
10 the final design. And when we say modeling, we use  
11 sophisticated computer BIM modeling that requires huge  
12 amounts of time to input the data. The model doesn't run  
13 itself. This is not AI. And even AI has so many flaws in  
14 it. There was no AI when we did this. The model does not  
15 run itself. We have to put in all the parameters into the  
16 BIM modeling to get the output. And then when they fail,  
17 we have to think about it and retweak them and put them  
18 back in again. But I want to be clear that we didn't set  
19 out with this design solution in hand when we started the  
20 project. We did not contract with our client to design a  
21 building with this particular outcome. We didn't know the  
22 outcome.

23 Another example of this process of research and  
24 design iteration and experimentation that we used to  
25 design energy mitigation measures for solar heat gain was

1 on the building's west and south facades. The building's  
2 primary facades faced west and south, which were designed  
3 to sustain thermal exposure to the sun all day with no  
4 fluctuation in thermal heat gain. These are the two  
5 facades of the building that typically, in Southern  
6 California, get the most sun in California, actually.  
7 Past energy solutions were incorporated into the design of  
8 the building and were conceived to maximize energy  
9 efficiency of the structure as an overall. We  
10 hypothesized there might be a way to gain even greater  
11 energy efficiency savings through the incorporation of a  
12 system of exterior sunshade screens.

13 And, by the way, in the exhibit that Kreig showed  
14 earlier which had all of those computerized and very  
15 colorful modeling, those were models of these sunscreen --  
16 sunshade screen that we had to experiment with to design  
17 to come up with.

18 The sunshades, we hypothesized that by putting  
19 the sunshades on the outside of the building, on the  
20 outside of the windows -- and think about it. How many  
21 buildings do you see with sunscreens on the outside of the  
22 buildings. This is not a normal thing. This is not  
23 something that was done before -- that we had done before.  
24 The sunshades are laser cut, perforated middle panels  
25 installed over the windows vertically and in front of the

1 window to prevent infiltration of solid heat gain or  
2 glare, while allowing daylight views when you're inside  
3 the building.

4           So conceptually you get it. You put a curtain,  
5 you put a sunshade outside of the building. But if it's a  
6 solid piece of metal you can't see out. If it's a solid  
7 piece of metal, it doesn't let light in. So what is the  
8 degree of compromise between it being solid and being  
9 transparent, between letting in too much light, between  
10 letting in too much heat. That's the experimentation that  
11 we had to do, and that's what some of those computer  
12 modeling exhibits that Kreig had put on his screen earlier  
13 reflected. This alternative idea postulated that by  
14 putting the screens outside the windows the workers could  
15 move them. We decided we should maybe also make these  
16 screens movable because the sun is static. The sun moves.  
17 The sun moves in the summer. It moves in the winter.  
18 It's in different positions in the sky in the morning and  
19 in the afternoon.

20           So why do a one-blanket solution for every type  
21 of sun and solar heat gain on a building? So we  
22 postulated, let's let the workers inside the buildings and  
23 the inhabitants of the building move -- be able to move  
24 these screens themselves. They can open the sliding doors  
25 go out on the balcony and slide the screens open and

1 close, open the windows and slide them and close to let  
2 more light in or less light in, depending on the time of  
3 the day, depending on summer or winter. And this would  
4 allow them to mitigate the heat gain within the building  
5 at critical times and therefore, result in a lower use of  
6 HVAC air conditioning brining down -- improving the energy  
7 efficiency of the building.

8 But there was so much uncertainty here. The  
9 uncertainty lay in the amount of transparency incorporated  
10 into the screen. The more transparency, the greater the  
11 heat gain, the greater opacity, the less light entered  
12 into the building but the greater the heat gain benefit.  
13 Again, we prepared computer model BIMs and performed  
14 numerous calculations to determine solar penetration. We  
15 experimented, and it became clear that when we came to the  
16 solution, that solution was converted into a computer  
17 controlled laser cut aluminum panel that became the  
18 building's exterior sunshade screens and effectively  
19 mitigated the energy imbalance as I described.

20 So I hope I've demonstrated our process and made  
21 clear that we solved for a lot of uncertainties. But I've  
22 only talked about a couple in this building. There are  
23 numerous. These are not cookie-cutter buildings that we  
24 do, and so many qualified projects are not cookie cutter.  
25 We've excluded all the unqualified projects. And within

1 the qualified projects, we've excluded all the regular  
2 stuff that an architect does, designing the elevators,  
3 designing, you know, all the typical stuff. We've  
4 excluded all of this. I'm only highlighting the qualified  
5 items here. Our solutions were not standard out of the  
6 box or off-the-shelf ideas or products. The building,  
7 while it looks beautiful, even if I may say so myself, is  
8 technically sophisticated. It is so highly designed and  
9 so demonstrative of the research that was developed to  
10 make it function as it does.

11 Another example -- I'm only picking two of the  
12 examples, and this example is a house. Another example is  
13 of our qualified research and design that can be seen in  
14 the in the Sapphire Umeo Project. This project involved  
15 designing a unique residential home situated on a side of  
16 mountain that was designed to sustain thermal exposure to  
17 the sun all day with no natural cover. It was very  
18 exposed. And our clients wanted an energy efficient  
19 house. They loved exposed concrete and natural wood.  
20 Sounds normal to us at the onset. We realized several  
21 factor that made achieving this difficult once we started  
22 the project.

23 And I reiterate that when we contract with a  
24 client, we do not a detailed that uncovers every factor  
25 needed to be addressed to complete the project. In this



1 case, designing height limits for the side required the  
2 footprint of the house to be spread out -- to be spread  
3 out. We were only allowed one story above street level,  
4 and we can go down into a basement that walked out. But  
5 the clients wanted a very large house. This is not a  
6 small house. And the only way to fit it in was to create  
7 a very large single story, one piece of the house. As a  
8 result, it had an immense amount of roof.

9 The roof is the weakest point in energy  
10 efficiency. You got the sun baking down on the roof, and  
11 that is the weak point. How to solve for this? In  
12 addition, they wanted to use concrete and a lot of glass,  
13 inherently, two other materials that are not conducive to  
14 energy efficiency. And so you can see that we had many  
15 uncertainties like this that we had not worked on other  
16 houses that we've done previously. And as such, we  
17 were -- we were uncertain whether a design could be  
18 achieved that could resolve these uncertainties.

19 In the case of a house that we're contracted to  
20 design -- and we have two of them again in our project  
21 sampling -- we are not just laying out the room agencies,  
22 such as where the kitchen goes relative to the garage  
23 because you want to carry the groceries in. No. That's a  
24 given. That's a part of what we know at the start.  
25 That's a part that's expected of most architects. We're

1 not doing that. It's not in the qualified research. It's  
2 excluded. It's extracted out. That's the simple part.

3 The complexities result in the unknowns that we  
4 discover in the process, such as fire mitigation measures  
5 needed because the house is situated on the top of trees  
6 and a fire prone area, such as in the Barker residence.  
7 It's another one of the samples. How to solve for them in  
8 a manner that meets code but does not effect the energy  
9 efficiency or aesthetics is what we're talking about here.  
10 That's what the research and development and  
11 experimentation is about.

12 Getting back to the Sapphire where it's the  
13 client's desire for concrete or exposed concrete, concrete  
14 is inherently poor thermal conductivity. It's very  
15 conductive. It's porous and easily allows heat to  
16 permeate and transfer through it. We experimented with  
17 several design alternatives for insulating the concrete.  
18 Traditional insulation alternatives would place insulation  
19 on the anterior side of the walls resulting the concrete  
20 is being furred out to accept the insulation and thus,  
21 hiding the desired exposed concrete on the interior.  
22 After extensive analysis using the structured  
23 experimentation as I've discussed, we concluded that the  
24 design might include insulation placed within the  
25 thickness of the concrete wall itself.

1           Well, just think about that for a minute. How do  
2   you get that insulation in there? Concrete wet when it's  
3   poured. It's extremely heavy. But how do you get that  
4   insulation in it. This is not standard construction.  
5   This was a novel approach that we hypothesized. And this  
6   novel approach presented technical and logistical  
7   complications that we needed to thoroughly research and  
8   test in order to solve. We designed prototypes, prototype  
9   wall on the side to test the energy efficiency. To design  
10  this wall, we had to model it. We had to do computer  
11  modeling. We had to work with very specific contractors  
12  and people that know about concrete. We had to experiment  
13  and get it into this design.

14           In doing this, we discovered that the design  
15  alternative that we thought would work was just not  
16  feasible. It was not constructible. It could not be  
17  built. Having insulation inside the concrete walls  
18  required the concrete walls to have an interior support  
19  structure to hold it in place during the pour of heavy wet  
20  concrete. Existing construction processes do not have  
21  anything like this. Working with structural analysis, we  
22  developed a method of placing foam standoffs to keep the  
23  insulation in place while not interfering with the pour.

24           We had to design these form standoffs. You can't  
25  go to Home Depot and buy this stuff. It turned out the

1 solution was insulation that had integral custom design  
2 standoffs allowing stability of the foam during pour.  
3 This was an experimental approach that had to be proven.  
4 We engaged the contractor to perform a test by making  
5 full-scale mock-ups of the section of the wall, and it  
6 proved successful. If we had simply followed the  
7 traditional methods, we would have recommended furring out  
8 all the interior walls, put in some traditional or  
9 conventional soft bedding insulation and gravel over it,  
10 but it wouldn't have been a house that we set out to  
11 design our clients wanted us to have.

12           You can see that by developing in innovative  
13 approach and the integration of materials for specific  
14 purpose rather than the common solution, we were able to  
15 create a design that achieved energy efficient objectives  
16 and resolve all these other uncertainties. This was not  
17 the only uncertainty we had to overcome. One of the  
18 problematic requirements was that it had to be -- the  
19 clients had to be able to occupy exterior patios, sit  
20 there and look at the view of the ocean in the distance  
21 down the canyon. But the situation of the house, there  
22 were prevailing winds that came up off the ocean and to  
23 the house, which made it very uncomfortable and buffered  
24 the house.

25           Additionally, these patios were exposed to a

1 strong afternoon western sun. And after testing several  
2 alternative design solutions, we came up with an  
3 innovative approach to develop movable perforated steal  
4 metal screens that could be adjusted to protect the house  
5 from intense sunlight, as well as other mitigation against  
6 the wind that swept up through the canyon. Our  
7 calculations and modeling showed that the shadows of  
8 these -- the shading of these screens provided reduced  
9 energy expenditure needed for air conditioning and  
10 simultaneously provided shade on the patio. Removable  
11 screens also function as windshields, further protecting  
12 the building.

13 Another problem we discovered is that the wind  
14 rattled the screens. We didn't know this was going to --  
15 we had to solve for this after the fact. Yeah, the  
16 screens blocked the wind, but they rattle. So then we had  
17 to come up with a whole new kit of parts, design them to  
18 ensure they could move but not rattle. We considered  
19 designs involving custom screens that was freely  
20 removable, yet strong enough to resist the wind. We  
21 experimented with it and, ultimately, we prevailed and it  
22 was built that way.

23 Another item -- and this will be the last of it,  
24 and there are several. We faced -- we were faced with  
25 designing custom cantilevers that could support the weight

1 of steel, the steel panels for the wind screens as well as  
2 the cantilevers' own weight, as well as zero deflection  
3 above the movable sliding doors. We wanted large-style  
4 cantilevers. That's a conventional -- large-style roof  
5 overhangs. That's conventional. That's not part of  
6 our -- that's part of our unqualified. We wanted these  
7 because they shade the building. Yeah. Okay. Everybody  
8 knows that. But how to get them, the cantilever out there  
9 without sagging, limiting the movement of our windscreens  
10 without impacting the movability of our sliding doors  
11 presented a hug problem.

12 These are 15 to 18 foot cantilever-covered  
13 patios. So we came up -- we hypothesized and came up with  
14 an idea that if we made custom beams that were curved, not  
15 a straight beam -- a custom beam that was curved and  
16 delivered to the site that once you load it and put all  
17 the weight on it, the curve would flatten out, mitigating  
18 it sagging in the other direction. And we did that.  
19 That, you know, you can't dream this stuff up and just  
20 have it delivered to the site. That takes a lot of  
21 calculations, of analysis, of experimentation to get it to  
22 work exactly. That's what we did. They were delivered to  
23 the beam. The building works beautifully.

24 This house is a zero tolerance house. They are  
25 thin roofs. There is no -- it doesn't have a conventional

1 attic. There's no room for a conventional air  
2 conditioning systems. But we needed air conditioning in  
3 the building, and we needed energy efficient air  
4 conditioning in the building. We studied and analyzed and  
5 tested alternative air conditioning condenses from those  
6 traditionally used in most houses in this country. We  
7 determined that they were just not sufficient.

8           Number one, they couldn't fit. Number two, they  
9 were high energy usage. So we determined that a cutting  
10 edge variable refrigerant flow, a VRF, also known as a  
11 variable refrigerant volume, VRV system would provide the  
12 greatest efficiency. Now I know your eyes are glazing  
13 over at this, but at the time, VRV technology was brand  
14 new. And it was not even -- it was so new it was not even  
15 recognized by the State of California Title 24 energy  
16 codes. But we -- we knew that this was would be -- we  
17 hypothesized this would be a good solution for this house.  
18 And as a result, the mechanical engineers and we together  
19 had run rigorous energy efficiency tests to see if the  
20 technology could be integrated to create an energy  
21 efficient design for this building, for this house.

22           Part of this process actually included convincing  
23 the California Energy Commission that we -- that the  
24 condenses met the specifications of Title 24. During this  
25 process, we considered other design alternative such as

1 even changing the design of the house, but we determined  
2 that it was worth the experimentation, it's worth  
3 conducting all the tests and experiments to prove that  
4 this more efficient condenser was right for this project.  
5 And we did, and it's installed and it works beautifully.

6 JUDGE LONG: Mr. Abramson, I'm sorry. I have to  
7 interrupt you for a moment. We're running short in time.  
8 Could I ask you to maybe wrap up the rest of your  
9 testimony if you are able to?

10 MR. ABRAMSON: Okay.

11 JUDGE LONG: Thank you.

12 MR. ABRAMSON: I have like -- like three more  
13 minutes and I'm done.

14 JUDGE LONG: Okay. Thanks.

15 MR. ABRAMSON: Okay. When you look at our houses  
16 and buildings, they are high performance buildings  
17 designed to solve complex problems unknown at the onset.  
18 They do look beautiful, but don't let that deceive you or  
19 confuse you with high technology design, highly technical  
20 design, sophisticated resolutions to complex  
21 uncertainties. When you look at a Ferrari, you see an  
22 exquisite car, but you never forget the high performance  
23 and high engineering under the hood.

24 And I've only discussed in depth two projects,  
25 and I'm happy discuss all but we don't have time. You can



1       see the analytical and method of experimentation and  
2       having an approach to solving the design of these  
3       uncertainties that are not known at the onset, is a  
4       process that we use for all our qualified projects, not  
5       just the two I've mentioned. They do not solve -- these  
6       projects do not solve themselves. They are not  
7       standard-fitted parts.

8               Thank you very much.

9               JUDGE LONG: All right. Thank you, Mr. Abramson.  
10              Appellants' representative, Mr. Mitchell, does  
11      that conclude Appellants' presentation?

12             MR. MITCHELL: It does.

13             JUDGE LONG: All right. Thank you.

14             FTB, do you have questions for Mr. Abramson  
15      regarding his factual testimony?

16             MR. HALL: Yes, we do.

17             JUDGE LONG: All right. Mr. Hall, is your  
18      questioning going to be extensive? I want to get a sense  
19      of time.

20             MR. HALL: I believe it will depend partly on  
21      Mr. Abramson's responses, but I don't think our questions  
22      will take more than 15 to 20 minutes.

23             JUDGE LONG: All right. FTB, we'll go ahead and  
24      get started, but if we run over time, I'm aiming to have  
25      our morning calendar completed by 12:30. So if we run

1 over time, then we'll have to ask Mr. Abramson to come  
2 back on our continuance day for additional questions. All  
3 right.

4 FTB, you may begin.

5

6 CROSS-EXAMINATION

7 BY MR. HALL:

8 Q All right. Good afternoon, Mr. Abramson. Thank  
9 you for being here today. How long have you been  
10 practicing as an architect?

11 A 37 years.

12 Q And when did you become a partner or found  
13 Abramson Teiger Architects?

14 A In 1997. Well, it was called Abramson Architects  
15 prior to then. Then I had a partner, Abramson Teiger, and  
16 now we're back to Abramson Architects.

17 Q Very well. When I refer to Abramson Teiger, I'll  
18 just do that for purposes of the fact that this is the  
19 firm for these years at issue, but assume that I mean all  
20 iterations of the name.

21 A Sure.

22 Q Now, would you agree that Abramson Teiger is a  
23 successful architectural firm?

24 A Yes.

25 Q And would you say the firm has a good reputation?

1           A    Yes.

2           Q    The clients that seek you out, do they seek you  
3 out because of your reputation?

4           A    Yes, and for our ability to solve complex  
5 designs.

6           Q    Very well. During the taxable years at issue,  
7 how many projects would you estimate that Abramson Teiger  
8 worked on? So this would be 2013 to 2017.

9           MR. MITCHELL: Judge, we object to that. That's  
10 already in evidence.

11          MR. HALL: Okay.

12          JUDGE LONG: All right. You know, I believe  
13 Mr. Mitchell is correct that information is already in  
14 evidence. So I won't expect a specific number, but I  
15 think we all understand it to be a large number of  
16 projects.

17          MR. ABRAMSON: Correct.

18 BY MR. HALL:

19          Q    If you had to estimate, Mr. Abramson, how many  
20 projects would you say the firm has worked on in its  
21 entire existence?

22          A    Thousands of the 37 years.

23          Q    Okay.

24          A    But both large and small.

25          Q    Very well. And among those thousands of

1 projects, how many of these projects would you say  
2 Abramson Teiger or Abramson has failed to produce  
3 deliverable for a client?

4 MR. MITCHELL: Objection.

5 MR. ABRAMSON: I don't even know what you mean.

6 MR. MITCHELL: There's no definition of  
7 deliverable.

8 BY MR. HALL:

9 Q Failed to produce a design or failed to deliver  
10 for a client what the firm was hired to do?

11 MR. MITCHELL: Objection. It's speculation. And  
12 it's calling for projects that are undefined.

13 JUDGE LONG: FTB, can I have you please rephrase  
14 that question.

15 BY MR. HALL:

16 Q We're simply asking Mr. Abramson, who is what I  
17 understand to be the founder of this firm to clarify how  
18 many projects the firm has failed to produce a deliverable  
19 for what they were hired to produce for a client.

20 A The deliverables vary so much. Some projects  
21 we're hired to do feasibility study. Some projects we're  
22 hired to design the entire building, you know. Some  
23 projects change beginning to end. There's no, sort of,  
24 one answer. We -- we -- I would say we deliver a  
25 project -- we deliver to our clients. We don't fail our

1 clients.

2 Q So yeah. Just to clarify, Mr. Abramson, I'm not  
3 asking what types of -- specifically what types of  
4 projects the firm has been asked to perform. I realize  
5 there can be any number of projects and any range types of  
6 projects that the firm could be asked to perform. But  
7 among those, when your firm is hired, has the firm ever  
8 failed to produce what is has been contracted produce for  
9 a client? And what I'm understanding is that the answer  
10 is very little; is that correct?

11 A Correct. Because we go through and we solve all  
12 the uncertainties until we come up with a solution.

13 Q Thank you. Now with respect to the Barker  
14 Project, you mentioned that you partnered with a  
15 fenestration specialist regarding the solar heat gain  
16 coefficient of a proposed design?

17 A Partner would not be the right word, but there  
18 was a fenestrations glazing subcontractor. You know,  
19 we -- who helped us in coming up with the right  
20 specification for the project to meet the energy  
21 efficiency requirements.

22 Q Well, just for your knowledge, I believe the word  
23 partner is page 10 of your declaration on page 1557 of the  
24 exhibit binder.

25 A Okay.

1           Q   For the Panel's clarification, when you say the  
2   word fenestration, what are you referring to in lay terms?

3           A   Windows, the exterior closing windows --

4           Q   Thank you.

5           A   -- in glass, mostly glass. I mean glass, not  
6   solid doors and windows.

7           Q   So this window specialist was or was not an  
8   Abramson Teiger employee?

9           A   No, not an employee.

10          Q   And this person was employed by another company?

11          A   They were an independent subcontractor who was  
12   going to help in the construction of the house or to  
13   provide the windows.

14          Q   Do you recall the name --

15          A   And it wasn't just one by the way. There were  
16   several.

17          Q   Okay. For purposes of what's stated in your  
18   declaration, do you recall the name of this company?

19          A   No. I do not recall right now.

20          Q   With respect to a particular window from a window  
21   manufacturer, solar heat gain coal efficient is known by  
22   the manufacturer; correct?

23          A   It's known by the manufacturer for a specific  
24   specification of window. There are many different  
25   specifications. There are single-pane glass, duel-pane

1 glass, argon filled, vacuum filled, triple glazing, Low-E  
2 films, various things.

3 Q Correct. So there are many different variations  
4 of this windows, but at the end of the day when the  
5 manufacturer produces this window, they know what the  
6 solar heat gain coefficient is for the window?

7 MR. MITCHELL: Judge, we would object to that.  
8 This witness cannot testify to what some other party knows  
9 or doesn't know.

10 JUDGE LONG: FTB, we're going to confine  
11 Mr. Abramson's testimony to things he'll have personal  
12 factual knowledge of.

13 MR. HALL: Sure.

14 BY MR. HALL:

15 Q Mr. Abramson, with respect to the windows that  
16 you used in your buildings, was the solar heat gain  
17 coefficient known by the manufacturer beforehand?

18 A We had to select the appropriate window with the  
19 appropriate solar heat gain coefficient to contribute to  
20 the --

21 Q But that's not my --

22 A -- overall energy efficient --

23 Q That's not my question, Mr. Abramson. My  
24 question was whether this value is known, not whether you  
25 selected among different options.

1           A    Yes.

2           MR. MITCHELL:  Judge, again, objection.  He can't  
3   testify to what some other party knows or doesn't know.

4           JUDGE LONG:  Mr. Mitchell, thank you.

5           And, yeah, Mr. Hall, you're reminded please --  
6   two things.  Please only ask our witness things he has  
7   personal factual knowledge of.  And also, please give him  
8   an opportunity to fully respond before you speak so it  
9   gives our stenographer the opportunity to be clear.  Thank  
10  you.  Please go ahead.

11          MR. HALL:  Thank you.

12  BY MR. HALL:

13          Q    Mr. Abramson, you stated that Abramson Teiger  
14  performed experiments with different types of glazing and  
15  film coatings?

16          A    Correct.

17          Q    So can you describe how you created a new film  
18  glazing or coating for a window?

19          A    You know, as Kreig mentioned in his  
20  demonstrative, we are not the manufacturer.  We are the  
21  designer.  We didn't physically create these windows.  We  
22  work with a fenestration or a glazing subcontractor to  
23  create the samples for what we have hypothesized.  Can you  
24  give us this glass with this film?  Yes.  What will the  
25  result and coefficient of shading be.  They told us after,



1 and we did this for several iterations. We did not make  
2 them ourselves. We designed and came up with specs to be  
3 made by the manufacturer.

4 Q Very well. Thank you.

5 JUDGE LONG: All right. Mr. Hall, I'm sorry to  
6 interrupt again, but we are running short on time. Do you  
7 have any final questions you want to ask? What I'm going  
8 to do is continue this case so that Mr. Abramson will come  
9 back and you can continue asking questions. But did you  
10 have anything else that you need to get to quick before we  
11 have to break for the day?

12 MR. HALL: No. That's fine, Judge.

13 JUDGE LONG: All right. I apologize for the  
14 inconvenience of having to continue this case but,  
15 unfortunately, we just have a packed hearing calendar  
16 today.

17 So the time is now 12:28. This case will be  
18 continued. My office will reach out and let you all know  
19 what the continuation date will be.

20 At that time, we ask Mr. Abramson if you could  
21 please return so that we have the opportunity for our  
22 Panelist, my co-Administrative Law Judges, to also ask you  
23 questions about your factual testimony, and the case  
24 presentations will resume at that time. So when it  
25 resumes, that means that FTB will have 90 minutes for its

1 presentation, and Mr. Mitchell will have 10 minutes for  
2 Appellants' rebuttal.

3 And that will conclude OTA's morning calendar.  
4 OTA will reconvene this afternoon for our afternoon  
5 calendar, which is a separate case, at 1:30.

6 So I want to thank you all for your attendance  
7 today. Do we have any questions before we break?

8 FTB, do you have any questions?

9 MR. HALL: No questions.

10 JUDGE LONG: All right. Appellants, any  
11 questions?

12 MR. MITCHELL: No, Judge. Thank you.

13 JUDGE LONG: All right. Thank you all. See you  
14 again soon. Bye.

15 (Proceedings adjourned at 12:29 p.m.)  
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WEDNESDAY, SEPTEMBER 27TH, 2023

DAY 2

JUDGE LONG: With that, we're on the record.

We are reopening the record in the consolidated Appeals of Abramson and Tieger, OTA Case Numbers 21067893, 21118984, and 21119139. This matter is being held before the Office of Tax Appeals. Today's date is Wednesday, September 27, 2023, and the time is approximately 2:00 p.m.

My name is Veronica Long, and I'm the lead Administrative Law Judge for this appeal. With me today are Administrative Law Judges Ovsep Akopchikyan and Josh Lambert.

With that, I'll ask the parties to please reintroduce themselves for the record. We will begin with Appellants' counsel.

MR. MITCHELL: Kreig Mitchell for Appellants.

MR. ABRAMSON: Trevor Abramson, Appellant.

JUDGE LONG: FTB.

MR. HALL: Nathan Hall for Franchise Tax Board.

MR. RILEY: Jason Riley for Franchise Tax Board.

JUDGE LONG: All right. Thank you.

Mr. Abramson, if you're ready, I can swear you in for your testimony today. I'm going to ask you to please

1       raise your right hand.

2

3                               T. ABRAMSON,

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

7

8               JUDGE LONG: All right. Thank you, Mr. Abramson.

9               With that, I think we're ready to begin. We left  
10       off with Mr. Abramson having concluded his testimony and  
11       being prepared to respond to questions.

12              FTB, at this time, would you like to continue  
13       asking Mr. Abramson questions about his factual testimony  
14       in this case?

15              MR. HALL: Yes. We just have a few more  
16       questions.

17              JUDGE LONG: All right. FTB, please go ahead  
18       when you're ready.

19              MR. HALL: Thank you.

20

21                               CROSS-EXAMINATION (continued)

22       BY MR. HALL:

23              Q     Good afternoon, Mr. Abramson. With respect to  
24       the Sapphire Umeo Project, in your declaration you stated  
25       that the firm engaged in a -- engaged a contractor,

1 performed a test by making a full-scale mock-up of a  
2 section of concrete wall; correct?

3 A Yes, that is correct.

4 Q And was this contractor a separate company or  
5 entity from Abramson Teiger?

6 A Yes, they were.

7 Q Okay. Did the firm enter into a contract with  
8 the contractor to perform these tests?

9 A No.

10 Q What tests did the contractor perform?

11 A The contractor built -- in this case, built a  
12 full-scale mock-up of a section of the wall.

13 Q Okay. And as far as you're aware, what were the  
14 results, if any, of these tests?

15 A We did this a few time. First few times it  
16 actually failed because we -- well, I actually explained  
17 in my previous testimony last week, so I don't really need  
18 to repeat it. But it failed, and then we had them -- we  
19 changed the designs and experimented and they built again  
20 until we got to a product and saw a mock-up that worked.

21 Q And are the results of these trials and tests  
22 included in the record?

23 MR. MITCHELL: Objection, Judge. There's no  
24 contract QREs that were claimed in this project. That's  
25 outside the scope of -- it's not even part of this case.

1 JUDGE LONG: All right.

2 MR. HALL: May I respond, Judge?

3 JUDGE LONG: All right. Go ahead, Mr. Hall.

4 MR. HALL: We're merely asking if the -- the  
5 witness just testified that tests were performed by a  
6 contractor on a concrete wall. We're merely asking if the  
7 results of those tests or records of those tests are in  
8 the record.

9 MR. ABRAMSON: I just want to say to clarify, the  
10 tests were not done on a concrete wall. We designed a  
11 concrete wall that needed to have insulation placed within  
12 it, like I explained previously, and they actually built  
13 this. So it wasn't like they were doing some tests on a  
14 wall. They were actually building it to see if it was  
15 buildable, and that's what that was. Our client hired the  
16 general contractors, not us, but -- so that's how the  
17 circle works.

18 BY MR. HALL:

19 Q Okay. So Abramson Teiger never paid the  
20 contractor any money to perform any research or any  
21 testing?

22 A No, our client did. We don't -- we don't pay to  
23 build the projects. Our clients pay to build the projects  
24 and that kind of -- Mr. Mitchell explained that we're  
25 only -- our portion of the work is only the design. We're

1 not the manufacturer at all.

2 Q All right. Thank you. In your declaration --  
3 this would be on page 1554 of the exhibit binder -- you  
4 mentioned that the firm used a special product,  
5 specifically, an insulation with standoffs to hold the  
6 insulation in place while the concrete is poured. Where  
7 did you find this insulation, and was it offered by  
8 another company?

9 A It -- this was a -- was not an on off-the-shelf  
10 item. The same contractor that we were -- that were hired  
11 by the clients that we were working with and us devised a  
12 method to create insulation with these kinds of standoffs.

13 Q So the contractor devised a method --

14 A No.

15 Q -- to use these stand offs?

16 A No, we did. The contractor just builds what we  
17 design. They are not designers. We're hired to  
18 experiment, not them.

19 Q On page of 63 of Abramson Teiger's credit study,  
20 the credit study states that the firm founded the  
21 insulation with standoffs. Is it your testimony that this  
22 credit study is inaccurate?

23 MR. MITCHELL: Objection. That's a leading  
24 question.

25 MR. HALL: I'm allowed. Judge, we're allowed to

1       lead the witness.

2               JUDGE LONG: All right. Let me just go ahead and  
3 mention that the Office of Tax Appeals is not a Tax Court,  
4 so our regulations provide that all relevant evidence is  
5 admissible. However, the California Rules of Evidence can  
6 be applied in weighing the evidence. Now, that being  
7 said, Mr. Hall, can continue his questioning, but as we  
8 stated last week we'll just have the testimony please  
9 pertain to -- apologies. Just a moment.

10              We'll ask the testimony to please pertain to  
11 Mr. Abramson's personal knowledge. And we don't expect  
12 him to have perfect recall of the credit study, which we  
13 understand was performed not by Mr. Abramson himself.

14              So also, I'll ask do either my co-Panelists have  
15 anything to offer?

16              All right. In that case, I'll let you continue  
17 with your questions, Mr. Hall.

18              MR. HALL: Thank you, Judge. I just want to  
19 clarify, Respondent is not asking the witness to testify  
20 beyond his own knowledge. We understand that, you know,  
21 there may be things that he doesn't know, and that's fine.  
22 We're asking him about his testimony in which he stated  
23 that they developed some type of insulation and standoffs,  
24 which appears to contradict the credit study. So I'll  
25 repeat the question.



1 BY MR. HALL:

2 Q Mr. Abramson, the credit study states that the  
3 firm found an insulation with standoffs. Is it your  
4 testimony that the credit study is inaccurate?

5 A No. The credit study is not inaccurate. I think  
6 you're picking up on semantics where -- on the word found.  
7 Together with the contractor and we -- we came up with the  
8 solution. We led the -- we were the inspiration for  
9 options to design how to do it, and together semantically  
10 we found a solution. The report is accurate.

11 Q Okay. So when you say found, can you be more  
12 specifying about what you mean? Did the --

13 A I can try.

14 Q I guess --

15 A I really want to try and make this clear. I want  
16 to help. I don't quite understand your question, but I  
17 want to try and help you.

18 Q Yeah. So what I'm getting at is there's a  
19 difference between finding something that exist, like a  
20 product you can purchase, even if it's unusual, versus  
21 inventing something new. So which is it?

22 A Well, there is also a difference between finding  
23 a product and finding a solution, and in this case we  
24 found a solution. We didn't go to Walmart and find a  
25 product. We brain stormed, experimented, and found a

1 solution together with the contractors.

2 Q Okay. On page 7 of your declaration, you stated  
3 that, quote, "Having insulation inside the concrete walls  
4 required concrete walls to have an interior support  
5 structure to hold it, meaning insulation, in place during  
6 the pour of heavy wet concrete. Existing construction  
7 processes do not have anything like this," unquote.

8 Are you familiar with composite insulated or  
9 cast-in-place wall systems?

10 A No.

11 Q Are you aware that these wall systems are systems  
12 in which concrete is poured around rigid insulation, which  
13 is held in place by standoffs?

14 A I'm not aware of that.

15 Q Okay.

16 A And I don't know when that system -- that product  
17 your referring to existed or not, but I'm not aware of it.

18 Q That's fine. And you stated in your testimony  
19 that the firm designed to form standoffs to hold  
20 insulation in place; correct?

21 A Yes.

22 Q And did you perform testing or experimentation to  
23 develop the formed standoffs?

24 A Like I said five minutes ago, or you asked me,  
25 the contractor built some full-scale mock-ups to test out

1       whether these standoffs and insulation could be -- could  
2       be placed in the formwork prior to -- while the concrete  
3       is being poured in. The other thing is that we wanted a  
4       very certain control of the spacing of the forms. Because  
5       when you strip concrete off the formwork, you see the  
6       marks where the forms were. And we didn't want random  
7       forms all over the walls inside somebody's house. So  
8       there was a whole lot of experimentation that we had to do  
9       to get exact placement of the forms and et cetera. I feel  
10      like I'm repeating myself again but --

11           Q     That's fine. That's fine. Thank you.

12           A     Okay.

13           Q     But just to clarify again, Abramson Teiger never  
14      paid for this -- to build the mock-ups. They did not do  
15      the mock-ups themselves; correct?

16           A     Correct. We don't pay for anything in the  
17      construction industry.

18           Q     So no expenses were incurred in creating these  
19      mock-ups?

20           A     No. The expenses are in us designing it. But no  
21      expenses did occur. We did not pay for the concrete, for  
22      the wood, for anything.

23           Q     As far as you're aware -- sorry. Let me back up  
24      for a minute. You also mentioned that tests were  
25      performed with respect to developing this -- this concrete

1 insulated wall?

2 A Yes. I feel I just answered that one second ago.  
3 I'm sorry.

4 Q Thank you. And none of these test results are  
5 recorded in the record; correct?

6 A I don't know if they're in the record that you're  
7 referring to, but certainly there were meetings that were  
8 held. There are meeting minutes that we take and issue  
9 from them. There are sketches that we mock-up during  
10 these kinds of things so that we can keep designing. It's  
11 not just all done by memory. But whether it was placed  
12 into the record of time for this -- for the FTB, I don't  
13 know if they're in there or not. But in our time entries  
14 it might refer to something as meeting notes or meetings  
15 or something to that effect.

16 Q Thank you. And I apologize. You may have  
17 alluded to this earlier. As far as you're aware, is  
18 Abramson Teiger the first company to design a wall using  
19 poured concrete around insulation?

20 A I'm not -- I can't -- I don't know. I don't know  
21 if we're the first or somehow I would like to say that  
22 it's almost impossible to -- no. I mean, I can't even  
23 speculate if we're the first, but I would find it highly  
24 unlikely that we're the first. Whether it's documented  
25 anywhere or whatever, I have no idea. But the walls we

1       were designing had to meet the choices that we were making  
2       for this project as I've discussed.

3           Q     So when you say that existing construction  
4       processes do not have anything like this, you're actually  
5       not sure?

6           A     I'm sure that 99 percent of the walls that the  
7       general contractors here in Southern California that work  
8       on residential construction do not have insulation in the  
9       walls.  They're -- they're -- if somebody wants a poured  
10      concrete wall, typically it's insulated on the inside.  
11      Sometimes it's not insulated and their house -- because  
12      it's an isolated wall in a house and they just want it for  
13      some many artistic expression, and they don't care because  
14      the overall house meets other energy requirements, but in  
15      this case all the walls were -- I mean, not all --  
16      90 percent of the walls were concrete.

17                It had -- the house had to perform from an energy  
18      point of view, and so the walls did contribute to the  
19      success or failure of the house from an energy standpoint.  
20      Not to mention, we had to be able to build the walls as  
21      well, the concrete walls.

22           A     Thank you.

23                MR. HALL:  Judge, I would ask the witness -- or  
24      the Panel to remind the witness to just answer the  
25      question, please.

1 BY MR. HALL:

2 Q Mr. Abramson, did you or the firm seek A patent  
3 or other intellectual property protection for developing  
4 this wall or these new standoffs as you say?

5 A No.

6 Q Are you aware that the type of wall described in  
7 your declaration where insulation is held in place using  
8 standoffs and concrete is poured around that insulation is  
9 referred to as a composite insulated wall that has been  
10 around since 1980s and patented by Robert Long and Robert  
11 Weinhardt in 1982?

12 MR. MITCHELL: Objection, Judge. That's calling  
13 an expert witness. He's almost testifying himself.  
14 That's not even a question.

15 JUDGE LONG: FTB, it's already asked a portion of  
16 this questions. I understand the point you're making.  
17 However, we're trying to ask -- we're not treating  
18 Mr. Abramson as an expert witness necessarily, just  
19 insofar as we're asking him to testify to his personal  
20 knowledge of his tax credits. So while I understand your  
21 line of questioning, I'm going to ask that the questions  
22 be narrowed in scope to Mr. Abramson's testimony.

23 And if FTB had an expert witness, you know, that  
24 would have been something we would have noticed quite a  
25 bit earlier in the case. So I'll ask you to go ahead and

1       continue.

2               Thank you.

3               MR. HALL: Thank you, Judge. Yeah. If the  
4       witness isn't aware, that's fine. We're --

5               MR. ABRAMSON: You know, I just want to say  
6       something. I'm aware of those systems, not in any detail,  
7       but I do know that those systems is almost an  
8       off-the-shelf product that you can buy or order to be  
9       customized. But you cannot control the finish to what we  
10      wanted in this house. You cannot get board formed -- and  
11      exterior board form finish made up of varying -- a very  
12      strict pattern of varying widths of boards, which is what  
13      we had in this house.

14              So that product might exist and as there are  
15      other products such as CMU Blocks, which are prefilled  
16      with insulation inside. It's a different product. It's  
17      not going to give you the aesthetic consideration that we  
18      wanted in this house, and that's why we had to design  
19      because we had a big vision for aesthetics, and then we  
20      had to solve that for the technology.

21              MR. MITCHELL: Judge, if I may? I think only 10  
22      minutes was reserved for cross-examination, and we used 10  
23      minutes in the prior hearing. And I think it's already  
24      past 10 minutes now.

25              MR. HALL: We'll begin our case in chief. Thank

1       you.

2               JUDGE LONG: All right. Mr. Hall, before you  
3 begin your case in chief, I need to turn it over to my  
4 co-Panelists to see if they have any questions for  
5 Mr. Abramson. So just to confirm, FTB, you've finished  
6 your questions of Mr. Abramson?

7               All right. I'm going to turn it over first to  
8 Judge Akopchikyan. Do you have any questions for the  
9 witness?

10              JUDGE AKOPCHIKYAN: I don't have any questions.  
11 Thank you.

12              JUDGE LONG: All right. Judge Lambert, do you  
13 have any questions?

14              JUDGE LAMBERT: This is Judge Lambert. I don't  
15 have any questions at this time. Thanks.

16              JUDGE LONG: All right. I also do not have any  
17 questions for Mr. Abramson.

18              Thank you for your testimony, Mr. Abramson.

19              MR. ABRAMSON: Thank you, Your Honor.

20              JUDGE LONG: Also because this is technically the  
21 conclusion of Appellants' case, I want to mention,  
22 Judge Akopchikyan, do you have any questions for  
23 Mr. Mitchell regarding his case presentation?

24              JUDGE AKOPCHIKYAN: Judge Akopchikyan speaking.  
25 I don't have any questions. Thank you.



1 JUDGE LONG: All right. Judge Lambert?

2 JUDGE LAMBERT: This is Judge Lambert. I don't  
3 have any questions. Thanks.

4 JUDGE LONG: All right. I also do not have any  
5 questions for Mr. Mitchell.

6 In that case, I'll ask FTB to begin its case  
7 presentation. You have 90 minutes. Thank you.

8 MR. HALL: Thank you, Panel. Thank you,  
9 Judge Long.

10

11 PRESENTATION

12 MR. HALL: Respondent will address the burden of  
13 proof, the exceptions to qualified research, including the  
14 funded research exception, and discuss other contested  
15 issues in these appeals. Respondent will then analyze  
16 aspects of the tests for qualified research as applied to  
17 Appellants' activities.

18 With respect to the burden of proof, Appellants  
19 claim that Respondent has raised new issues in this appeal  
20 and has the burden of proof. This claim is unsupported.  
21 Respondent's arguments are not new issues that shift the  
22 burden of proof. In the Appeal of Sierra Pacific  
23 Industries, among other cases, the Board of Equalization  
24 noted that if Respondent's position on appeal results in  
25 an a larger deficiency or requires the presentation of

1 different evidence, then a new matter has been introduced,  
2 and the burden to prove that new position shifts to  
3 Respondent.

4           However, if the assertion of a new theory merely  
5 clarifies or develops the original determination without  
6 being inconsistent or with it increasing the amount of  
7 deficiency, it is not a new matter shifting the burden of  
8 proof to Respondent. Respondent's position at appeal  
9 develops its original determination and is consistent with  
10 the original determination. Here, the issues in these  
11 appeals is whether Appellants are entitled to claim the  
12 California research credit as set forth in their amended  
13 returns. Respondent's position that Appellants are not  
14 entitled to the credits claimed has never changed.

15           On brief, Respondent has expounded on the reasons  
16 why Appellants are not entitled to the claimed credits.  
17 However, the issues raised in Respondent's briefing are  
18 limited to elements that Appellants are already required  
19 to establish to demonstrate entitlement to the credits  
20 claimed. Respondent's arguments do not increase the  
21 amount at issue or require the introduction of new  
22 evidence and, therefore, are not new issues shifting the  
23 burden of proof.

24           Appellants, in their second reply brief, cite to  
25 Paine, P-a-i-n-e, versus State Board of Equalization, in

1 support of their claim that the burden has shifted to  
2 Respondent. Paine does not support Appellants' position.  
3 In fact, Paine supports the finding that Appellants bear  
4 the burden with respect to these refund claims. In Paine,  
5 the California Appellate Court held that, quote, "In a  
6 suit for tax refund, the burden of proof is on the  
7 taxpayer not only to demonstrate the Board's determination  
8 is incorrect, but also to produce evidence from which a  
9 proper tax determination can be made. The taxpayer must  
10 affirmatively establish the right to a refund of the taxes  
11 by a preponderance of the evidence and cannot simply  
12 assert error and shift to the State the burden of  
13 justifying the tax," unquote.

14 Appellants bear the burden in these appeals.  
15 Appellants' brief on claims are resolved by analyzing an  
16 exclusion to qualified research, namely funded research.  
17 Research is often performed by a party pursuant to a  
18 contract with a third party. In these cases, the rules  
19 relating to contract research and the exclusion for funded  
20 research dictate which party may properly claim any  
21 research credits generated. Research can be excluded as  
22 funded in two independent ways.

23 First, research is considered funded where  
24 payment for the research is not contingent on the success  
25 of the research. And second, research is considered

1 funded if the party performing the research does not  
2 retain substantial rights in the research. Importantly,  
3 application of either of these exceptions ends the  
4 inquiry. If the activity is considered funded, it matters  
5 not whether the activity constituted qualified research.  
6 It's not eligible or for the credit as a matter of law.

7 With respect to substantial rights, in two of the  
8 five contracts, the client, not Abramson Teiger, retained  
9 exclusive rights in the results of the purported research.  
10 Treasury Regulation Section 1.41-4A subsection (d)(2),  
11 provides that if the taxpayer performs research under an  
12 agreement that confers on another person the exclusive  
13 right to exploit the results of the research, the taxpayer  
14 is not performing qualified research.

15 Here, according to Appellants, Abramson Teiger  
16 engages in qualified research to produce designs. These  
17 designs, which are represented through drawings,  
18 constitute the results of the purported research. In this  
19 context, exploitation of the research is the right to  
20 construct the building represented in the drawings. With  
21 respect to the Barker Project and the Brick & Machine  
22 Project, the client, not Abramson Teiger, retains sole  
23 ownership of the drawings and other documents produced by  
24 Abramson Teiger for the client.

25 This is shown on page 14, Article 7 of the Barker

1 contract marked as Respondent's Exhibit T, and page 15  
2 Article 8 for the Brick & Machine Project contract marked  
3 as Respondent's Exhibit B. Here, sole ownership is  
4 understood as synonymous with exclusive ownership. Thus,  
5 with respect to the Barker Project and the Brick & Machine  
6 Project, because the agreements confer on the client, the  
7 exclusive rights to exploit the results of the purported  
8 research, Appellants are entitled to no credit, even if  
9 they could show qualified research had been performed.

10 On page 24 of their second reply brief,  
11 Appellants argue that nothing in the contract language  
12 precludes Appellants from using the results of the  
13 research, including the information learned in building a  
14 similar structure for another client and, therefore,  
15 Abramson Teiger retains substantial rights in the  
16 research. First, the contract language precludes  
17 Appellants from using the results of the research. As  
18 just stated, the clients are the sole owners of the  
19 drawings and other documents produced by Abramson Teiger  
20 with respect to these projects. Therefore, Appellants  
21 contention is incorrect.

22 Second, using the information learned for future  
23 projects is not considered a substantial right. Treasury  
24 Regulation 1.41-4A subsection (d) (2), provides that  
25 incidental benefit for the performance of research,

1 including increased experience in the field of research  
2 does not constitute a substantial right in the research.  
3 In other words, the taxpayer's ability to apply gained  
4 experience learned through performing research does not  
5 constituent a substantial right for purposes of this  
6 exclusion. Thus, when Appellants' counsel states that the  
7 firm, may use information learned in building a similar  
8 structure for another client, this is not constitute  
9 substantial rights for purposes of the statute.

10 In Tangel V. Commissioner, the taxpayer claimed  
11 that it retained rights to use institutional knowledge  
12 gained from the performance of research. However, the  
13 United States State Board applying the aforementioned  
14 regulation held that such incidental rights do not  
15 constitute substantial rights for purposes of the  
16 exception. This is dispositive of the ultimate issue with  
17 respect to the Barker Project and the Brick & Machine  
18 Project. Under the applicable rules, research is also  
19 considered funded if payment to the taxpayer is not  
20 contingent on the success of the research.

21 Courts have interpreted this to mean that the  
22 inquiry turns on who bears the risk under the contract if  
23 the research fails. The regulations require an analysis  
24 of all agreements in determining the extent to which  
25 research is funded. There's no bright line test. Here,

1 payment to the firm is for services rendered and is not  
2 contingent on the success of the research. Appellants  
3 cite to Geosyntec and Fairchild in support of their  
4 contention that these contracts were fixed-priced  
5 contracts, and the Panel need look no further at the  
6 contract terms.

7           However, these case clarify that there's no  
8 bright line rule. Rather, the contractual arrangement  
9 must be analyzed to determine whether the activity is  
10 funded. As applied to the present case, Respondent first  
11 notes that the contracts at issue are contracts for  
12 architectural services, generally calling for a quote  
13 usual and customary architectural services. Appellants  
14 were hired specifically because they are experienced at  
15 performing the services that are the subject of the  
16 contracts.

17           Stepping back for a moment, it's important to  
18 know the context in which these contracts are entered  
19 into. By and large and as was the case with the projects  
20 at hand, Abramson Teiger uses a form contract developed by  
21 the American Institute of Architects, also known as the  
22 AIA. As evident from the first page of each contract  
23 contained in Respondent's Exhibits R through U, the  
24 document is titled "AIA Document B101," followed by a year  
25 then a sub-caption that reads, quote, "Standard form

1       agreement between owner and architect," unquote.

2               This standard agreement is developed by the AIA  
3       specifically for architects. In this context, there's no  
4       reason to believe that the AIA would develop a contract  
5       for architects under which the architects assumes  
6       significant risk. In fact, it's expected that under these  
7       contracts the architect assumes as little risk as  
8       possible. This logic is evident by examining the  
9       contracts here under which the firm is virtually  
10      guaranteed to be paid for its work, whether a design is  
11      completed or the client terminates the contract prior to  
12      completion.

13             Under these contracts, Abramson Teiger was  
14      generally entitled to payment for all services performed.  
15      For example, Article 11.10.2 of the contracts provides  
16      that, quote, "Unless otherwise agreed, payments for  
17      services shall be made monthly proportioned to  
18      the services performed" -- "shall be made monthly in  
19      proportion to services performed," unquote. This is shown  
20      on page 17 of Exhibit R, pages 21 and 28 of Exhibit U, and  
21      page 17 of Exhibit S. Geosyntec, a similar provision  
22      existed with respect to one of the contracts referred to  
23      as the Seal Beach Contract.

24             However, in Geosyntec, the District Court also  
25      noted that if the Navy terminated the contract and



1       acquired work similar to the work terminated, the taxpayer  
2       would be liable for any excess cost for the similar work.  
3       Such risk is not present here. Under Articles 9.2 and 9.6  
4       of the contracts, if the client suspends or terminates the  
5       contract, Abramson Teiger is unconditionally entitled to  
6       compensation for services performed. This is shown on  
7       pages 14 and 15 of Exhibit R and S, and pages 18 and 19 of  
8       Exhibit U, Articles 9.2 and 9.6.

9               Under the contracts, the firm has a remedy for  
10       non-payment found under Article 8. This is also different  
11       from the Geosyntec where the payment was contingent solely  
12       on performance. Appellants contend that the contracts are  
13       fixed price. Respondent disagrees. The contracts allow  
14       for price modifications found in Article 3.3.2, Article  
15       3.3.3, as well as Article 4 for additional services  
16       charged in excess of the contract price. Appellants claim  
17       that they typically did not charge for additional  
18       services.

19               However, whether Appellants actually charged for  
20       additional services is not dispositive. The fact remains  
21       that the contract provides for payment by the client to  
22       the architect for additional services when the need  
23       arises. Including, for example in Article 4.3.1.2, quote,  
24       "For services necessitated by the owner's request for  
25       extensive environmentally responsible design alternative,

1     such as unique system designs, in-depth material research,  
2     energy modeling, or lead certification," unquote.

3             This language is found in Exhibit R, page 9,  
4     Exhibit S, page 9, Exhibit T, page 11, Exhibit U, page 13.  
5     In addition, page 13, Article 5.3 of Exhibit V, provides  
6     for additional services. The fact that the client bears  
7     the cost -- this cost under the contract further shifts  
8     risk away from the firm regardless of whether such  
9     additional service is actually charged. Each contract  
10    differs in it's precise terms. However, the firm is also  
11    entitled to compensation for either hourly charges for  
12    construction administration, reimbursable expenses in  
13    excess of the contract price, or both. The firm also  
14    typically reserves the right to increase its hourly rate  
15    after a certain period.

16            Finally, the client, not the firm, is generally  
17    responsible to pay for changes in scope of work as  
18    additional services. None of the features of these AIA  
19    contracts are present in the contracts discussed in  
20    Geosyntec or Fairchild cited by Appellants. For example,  
21    in Fairchild, the Federal Circuit of Appeals found it  
22    significant that the contract require the taxpayer to  
23    return the progress payments if the contract was not  
24    successfully completed.

25            Here, no such provision exist. The contracts do

1 not require Abramson Teiger to return payment for services  
2 rendered if the project is not complete. To the contrary,  
3 as pointed out, the firm is generally entitled to payment  
4 for all services rendered up until the point of  
5 termination. Moreover, as we heard from Mr. Abramson,  
6 Abramson Teiger has rarely, if ever failed, to complete a  
7 design it was hired to produce. This is unlike the  
8 contracts in Geosyntec and Fairchild where genuine  
9 research was called for and genuine research existed that  
10 the research might not be successful. Because there's  
11 virtually no risk whether some design will be achieved,  
12 the only risk is whether the firm will get paid for its  
13 services rendered, which it will.

14 Instead, with respect to the projects at issue,  
15 the client bore the risk that if something were to happen  
16 to cause it to terminate the contract, the firm would  
17 still be paid for services rendered even if the client  
18 never received a completed design. Considering the  
19 totality of the contract terms on balance, the client, not  
20 Abramson Teiger, bore the risk under the contracts.  
21 Because the purported research, that is the subject of the  
22 contracts in this case, are funded by the client pursuant  
23 to Internal Revenue Code Section 41(d)(4)(H), the Panel  
24 need not -- excuse me -- the Panel need not consider  
25 whether any of the activity constitute qualified research.

1 Appellant's claims must be denied.

2 For the sake of completeness, however, Respondent  
3 will address the other issues raised in these appeals. To  
4 briefly address the disagreement regarding copyright law,  
5 Respondent's point is simply this. Research in the arts  
6 is excluded from the definition of qualified research  
7 pursuant to Internal Revenue Code 41(d)(4)(G). Generally  
8 speaking, works of art, including architectural works are  
9 afforded copyright protection. Therefore, it is  
10 reasonable to conclude that broadly speaking, production  
11 of an architectural design is excluded as research in the  
12 arts.

13 That's not to say that an architectural firm  
14 could never perform qualified research. But taxpayers may  
15 not simply allege, as Appellants have done here, that the  
16 existence of a novel design is prima facie evidence of  
17 qualified research. Rather, Appellants must demonstrate  
18 that with respect to specific and discrete business  
19 components that it performed activities satisfying the  
20 distinct requirements of qualified research. Furthermore,  
21 it is universally understood that architectural design  
22 accounts for aesthetics. Abramson Teiger's designs are  
23 indeed visually attractive and not by accident.

24 In fact, the firm is contractually obligated to  
25 consider aesthetics in its designs. This is shown in

1 Article 4.2.5.1 of the Brick & Machine contract, which is  
2 Respondent's Exhibit V, as well as Articles 3.2.5.1 and  
3 3.2.5.2 of all other contracts shown in Respondent's  
4 Exhibits R through U. Under Treasury Regulation  
5 1.41-4(a)(5)(ii), activities that relate to aesthetics,  
6 style, taste, or other design factors are not qualified  
7 and must be separated from activities relating to discrete  
8 functional components.

9 Appellants have failed to separate and  
10 distinguish the firm's nonqualified activity relating to  
11 aesthetics from its other activities. Instead, Appellants  
12 claim that all of their design activity constitute  
13 qualified research. Appellants have failed to satisfy the  
14 burden to demonstrate the extent to which the claimed  
15 activities and hours are not qualified. Throughout their  
16 briefing, Appellants maintain that the design process is,  
17 quote, "Exactly what qualifies as a process of  
18 experimentation for purposes of the research tax credit,"  
19 unquote.

20 MR. MITCHELL: Judge. Judge, I'm sorry to  
21 interrupt, but the argument is attributing things to us  
22 we've never said, clearly.

23 JUDGE LONG: I understand. Mr. Mitchell, I'm  
24 going to ask you to save your remarks for your rebuttal.  
25 We'll go ahead and let Mr. Hall continue. I'll remind you

1       that we do have a transcript in the case and that these  
2       hearings are saved on our YouTube channel, so we have  
3       everything.

4               MR. MITCHELL: Thank you.

5               JUDGE LONG: So I'm going to let Mr. Hall  
6       continue. Thank you.

7               MR. RILEY: If Mr. Mitchell could also mute his  
8       mic during the presentation, that would be helpful. Thank  
9       you.

10              MR. HALL: That quote, just to be clear, is from  
11       Appellants' briefing. So I'd be happy to point that out  
12       sometime after the hearing if the Panel would like, but  
13       I'll just start where I left off.

14              Throughout their briefing, Appellants maintain  
15       that the design process is, quote, "Exactly what qualifies  
16       as a process of experimentation for purposes of the  
17       research tax credit," unquote. This forms the basis for  
18       Appellants' mistaken claim that their design process  
19       constitutes qualified research. Appellants emphasize that  
20       the buildings they designed were entirely custom and did  
21       not exist prior to Appellants designing them and are,  
22       quote, "Entirely new to the world," unquote. Appellants  
23       maintain that because the building designs are novel, they  
24       constitute prima facie evidence of qualified activity.

25              However, the same novelty argument was advanced

1 by the taxpayer in Little Sandy Coal, and squarely  
2 rejected by both the Tax Court and the Seventh Circuit  
3 Court of Appeals. In Little Sandy Coal, the taxpayer, a  
4 ship builder, alleged that substantially all of its  
5 activity with respect to design of barge and dry dock  
6 constituted a process of experimentation because the  
7 projects were new to the taxpayer and differed from any  
8 previous designs. However, the Tax Court rejected this  
9 argument noting that the novelty of a business component  
10 does not establish that the work involved in developing a  
11 component involved the process of experimentation.

12 On appeal, the Seventh Circuit Court of Appeals  
13 affirm the Tax Court stating, quote, "The Tax Court also  
14 rightly rejected the taxpayer's novelty argument, namely  
15 that because the majority of the tanker and dry dock was  
16 new, substantially, all of the activities in designing the  
17 vessels constituted elements of a process of  
18 experimentation." As it did before the Tax Court, the  
19 taxpayer repeatedly emphasizes that the 11 vessels in  
20 question were first in class and that the taxpayer had  
21 never built a dry dock before.

22 But the Tax Court correctly recognize the  
23 Treasury Regulation Section 1.41-4(a)(6) requires the  
24 substantially all tests be applied in reference to  
25 activities, not physical elements of the business

1 components being developed or approved. So the novelty of  
2 the business component cannot be the basis for measuring  
3 the proportion of research activities that constituted  
4 elements of a process of experimentation," unquote.

5 Respondent asks the Panel to follow the Tax Court  
6 and the Seventh Circuit in finding that the process of  
7 experimentation and qualified research must be shown  
8 through activities and not merely by pointing to something  
9 that is, quote, "New to the world." Respondent believes  
10 it's self-evident that although qualified research may  
11 result in a novel design, not every novel design is the  
12 product of qualified research.

13 Finally, we heard from Mr. Abramson that their  
14 designs are sophisticated, but that's exactly why they're  
15 hired to perform this task. The firm has institutional  
16 knowledge in designing buildings. However, the mere fact  
17 that a design is sophisticated does not mean that  
18 qualified research took place to design it. Rather,  
19 qualified research is based on a very specific set of  
20 activities.

21 Moving on with respect to the business  
22 components. Appellants argument regarding the business  
23 component test is not supported by the statute or case  
24 law. The business component is the subject of qualified  
25 research. It is the thing which a taxpayer seeks to



1 improve or develop by engaging in qualified research.  
2 Appellants have stated this much correctly. In their  
3 second reply brief on page 19, Appellants recognize that,  
4 quote, "The research activity rules are just applied to  
5 some subset of components or subcomponents and the test  
6 will either be met or not met for those components or  
7 subcomponents," unquote.

8 In the treasury regulation example frequently  
9 used, the business component is not the engine but a  
10 component of the engine, a part of the engine. Similarly  
11 here, business component is not the entire house but is a  
12 discrete component of the house. However, Appellants  
13 confuse the concept by simultaneously maintaining that  
14 their purported research activity synonymous with their  
15 design activity is the business component. For example,  
16 Appellants also state that Appellants business component  
17 is the formula for how to construct a custom building.  
18 Taking Appellants word here that that the formula for  
19 designing a custom building is the business component,  
20 then Appellants must show that they performed qualified  
21 research in order to improve such formula or technique.

22 It's obvious from the briefing, however, that  
23 Appellants do not claim to have performed research with  
24 respect to improving the design process itself. They  
25 simply used the design process in designing their

1 projects. Additionally, Appellants confirm that the  
2 architectural design process is, quote, "Methodical and  
3 structured process," unquote, which is described in  
4 standard architectural textbooks. Here, by failing to  
5 identify any discrete components, Appellants have failed  
6 to satisfy the burden as the tests for qualified research  
7 must be applied to such business components as identified  
8 by them.

9 Appellants also incorrectly apply the  
10 shrinking-back rule under Treasury Regulation  
11 1.41-4(b)(2). As shown in the example on page 6 of their  
12 reply brief, Appellants claimed to have applied the  
13 shrinking-back rule by reducing employee hours for project  
14 time they considered to be non-qualifying. We heard this  
15 again from Mr. Abramson during his testimony that  
16 Appellants claimed to have excluded certain time spent on  
17 the projects. This is not application of the  
18 shrinking-back rule.

19 Appellants' exclusion of the non-qualifying  
20 employee hours relates to precision in claiming qualified  
21 expenses under Internal Revenue Code Section 41(b). By  
22 contrast, the shrinking-back rule relates to the level at  
23 which the test for qualified research are applied.  
24 Appellants are already required to exclude non-qualifying  
25 employee time in accordance with Treasury Regulation

1 1.41-2(d)(1), which provides that, quote, "If an employee  
2 has performed both qualified services and nonqualified  
3 services, only the amount of wages allocated to the  
4 performance of qualified services constitutes an in-house  
5 research expense," unquote.

6 Here, Appellants' removal of what it believes to  
7 be non-qualifying employee hours illustrates application  
8 of the aforementioned regulation relating to allocating  
9 non-qualifying hours for determining qualified expenses.  
10 By contrast, Treasury Regulation 1.41-4(b)(2), relating to  
11 qualified activities provides that the requirements for  
12 qualified activity are tested at the business component  
13 level first, and then if they do not satisfy the  
14 requirements at that level, the shrinking-back rule allows  
15 the test for qualified activity to be applied as to a  
16 subset of the business component.

17 As stated earlier, Appellants have failed to  
18 identify any business components and failed to support  
19 their argument they have applied the shrinking-back rule.  
20 Appellants in the application of the rule is illustrated  
21 in Appellants' counsel's statement that, quote, "We were  
22 able to shrink-back to just the qualifying time," unquote.  
23 Again, this is not shrinking-back rule. Shrinking-back  
24 refers to the business component, not qualifying time.

25 Furthermore, Appellants' own records show that if

1 the test for qualified activity were to be applied at the  
2 level of each project location, virtually all of the  
3 projects would fail to satisfy substantially all  
4 requirements. This is described in more detail in  
5 Respondent's reply brief beginning on page 14. It will be  
6 addressed later as well.

7 During their presentation, Appellants presented  
8 argument with respect to the IRS' project approach method.  
9 However, this relates to expenses, not qualified  
10 activities. Before computing a taxpayer's qualified  
11 expenses, the taxpayer must first demonstrate that it  
12 engaged in activities satisfying requirements of qualified  
13 research. This is not only common sense, but evident in  
14 the application of the Cohan rule as applied to research  
15 credit cases such as United States versus McFerrin. Under  
16 this line of cases, taxpayers must first demonstrate that  
17 they have engaged in qualified activity prior to  
18 estimating qualified expenses.

19 After demonstrating that it engaged in qualified  
20 activity, taxpayers' qualified expenses are analyzed and  
21 determine which expenses relate to such activities.  
22 Finally, once expenses are shown, the taxpayer is required  
23 to determine its fixed-base percentage and base amount in  
24 computing the credit. This is further supported by the  
25 Office of Tax Appeals' holding in Appeal of Swat-Fame,

1       which concluded that Appellants failed to demonstrate  
2       activities constituting qualified research and, quote, "As  
3       a result of the above holding, there are no qualified  
4       research expenses."

5               In that appeal, the opinion analyzed the  
6       taxpayer's activities first, and once concluding that no  
7       qualified research was performed, correctly concluded  
8       there were also no qualified research expenses.  
9       Appellants' analysis incorrectly reverses this order,  
10      essentially arguing that it has provided evidence of  
11      qualified wages in order to demonstrate activities. For  
12      the reasons just described, Appellants have failed to  
13      satisfy their burden to establish entitlement to the  
14      credits. For the sake of argument, however, even if  
15      Appellants were to overcome these inadequacies, Appellants  
16      have failed to demonstrate that their claimed activities  
17      satisfy the four tests for qualified research.

18             These tests include the business component test,  
19      the Section 174 Test, the technological and nature test,  
20      and the process of experimentation test. Respondent will  
21      highlight various aspects of these tests in relation to  
22      the projects at issue. According to Appellants' credit  
23      study, the Brick & Machine Project involved the creation  
24      of a multi-use building, which included retail space,  
25      office space, and parking.

1 Appellants identify three primary uncertainties  
2 with respect to this project. First, they claimed to be  
3 uncertain as to whether they can design a building that  
4 was energy efficient as possible. Second, they claimed to  
5 have been uncertain about whether they could design a  
6 building that was structurally sound. And third, they  
7 claimed to have been uncertain as to whether they could  
8 design a building that met various code and other  
9 requirements. Under the Section 174 Test, deductible  
10 expenses under Section 174 include research and  
11 development cost in the experimental or laboratory sense  
12 for activities intended to discover information that would  
13 eliminate uncertainty concerning the development or  
14 improvement of a product.

15 The uncertainty as described by Appellants are  
16 not genuine uncertainties under IRC Section 174. Rather,  
17 these uncertainties are generic uncertainties unrelated to  
18 the development or improvement of a product. The terms  
19 uncertainty, development, and improvement, have been the  
20 subject of recent interpretation in cases involving the  
21 research credit. This language is based on the  
22 Section 174 regulations highlighted for convenience in  
23 Respondent's first visual aid.

24 In Little Sandy Coal versus Commissioner, the  
25 Seventh Circuit Court of Appeals noted that, quote,

1 "Generic uncertainty is inherent in constructing or  
2 manufacturing a product. That involves questions like,  
3 will this tire fit? What kind screws are needed to attach  
4 this panel, or will this weld hold up this truss? But  
5 uncertainty in the Section 174 -- uncertainty in  
6 Section 174 means something more," unquote.

7 Expenses satisfying Section 174 must be incurred  
8 in the actual improvement or development of a product.  
9 This concept of generic uncertainty was reaffirmed in Betz  
10 versus Commissioner where the Tax Board, again, recognized  
11 that the term development as it relates to the development  
12 or improvement of a product for purposes of Section 174,  
13 requires, quote, "Some advancement in technology or  
14 product concept as opposed to your construction."

15 Turning to the Brick & Machine Project, in  
16 improving the building's energy efficiency, Appellants  
17 claim that they quote, "Hypothesized by using exterior  
18 screens to block the sunlight would help cool the  
19 building." First, Appellants have not demonstrated how  
20 uncertainty existed in determining whether an exterior  
21 screen would help shade and cool the building. It is  
22 obvious that a screen provides shade. This is not the  
23 subject of research.

24 Second, even if Appellants could establish that  
25 this information was unknown, they have failed to produce

1 research documentation demonstrating a process of  
2 experimentation to eliminate this alleged uncertainty. In  
3 his declaration, Mr. Abramson states more specifically  
4 that the uncertainty, quote, "Lay in the amount of  
5 transparency to be incorporated into each screen,"  
6 unquote. Mr. Abramson describes the trade off between  
7 allowing less light and less heat gain versus more light  
8 and more heat gain. He states that calculations were  
9 performed to determine the amount of solar penetration.

10 There is no Section 174 uncertainty here. The  
11 amount of light that will enter a room or solar  
12 penetration of a particular screen design is a question of  
13 generic uncertainty. Experimentation is not required here  
14 in order to measure light. Moreover, as just noted,  
15 development under Section 174 must relate to some  
16 advancement in product concept. Here, it cannot be  
17 reasonably said, for example, that a screen that is  
18 30 percent transparent represents an advancement or  
19 development when compared to a screen that is 60 percent  
20 transparent.

21 In determining the desired transparency of a  
22 particular screen, that may depend on numerous factors and  
23 considerations. However, this determination does not  
24 constitute development in the Section 174 sense. It  
25 merely represents a choice concerning a generic



1       uncertainty for which Abramson Teiger already has the  
2       information available to determine. While this choice may  
3       have many considerations, it may depend on budget,  
4       aesthetics, client preferences, advantages and  
5       disadvantages of using certain materials and so forth.

6               However, these considerations do not change the  
7       non-experimental nature of the activity as lacking genuine  
8       uncertainty and development for purposes of the Section  
9       174 Test. This is true of virtually all the design  
10      decisions described by Appellants as, quote,  
11      "Experimentation."

12             In their second reply brief, Appellants claimed  
13      to have provided in Exhibit L, the proposed design  
14      alternatives for the above ground structural elements of  
15      the building and corresponding stress testing that confirm  
16      Appellants' design with the outside structural -- that the  
17      outside structural elements failed. Pages 1 through 4 of  
18      Exhibit L attached to Appellants' reply brief do not  
19      reflect test results and do not constitute evidence of a  
20      process of experimentation.

21             The first four pages of Appellants' Exhibit L  
22      contain elevation drawings of the project and certain  
23      project details. These drawings appear to reflect a  
24      single set of working documents, not several alternatives.  
25      These documents do not reflect or establish that a

1 systematic process of experimentation took place, or that  
2 any purported test results were recorded and analyzed with  
3 respect to various alternatives. Appellants have failed  
4 to substantiate their claim. Pages 5 through 7 of Exhibit  
5 L show what appears to be a stress test performed with  
6 respect to one element. However, such testing was  
7 performed by a third party, Nous Engineering Incorporated.  
8 This is shown in Appellants Exhibit L, pages 5 through 7.

9 Furthermore, during his testimony, Mr. Abramson  
10 testified they hired -- that the firm hired a fenestration  
11 specialist, as well as a contractor, to perform tests on a  
12 mock-up of a section of wall. However, Appellants have  
13 not claimed contract research expenses. And further,  
14 Mr. Abramson claimed that the contractor, not Abramson  
15 Teiger, performed these activities. Appellants claim that  
16 there was uncertainty as to whether they can design a  
17 building that was structurally sound.

18 Presumably, Appellants performed load calculation  
19 with respect to a proposed design. And if the load  
20 calculations showed that the design is not structurally  
21 sound, this may require modification of the design;  
22 increasing the dimension of a post or the thickness of a  
23 wall, considering a different material. However, this is  
24 not genuine uncertainty under Section 174. It is a  
25 generic uncertainty like those mentioned in Little Sandy

1 Coal.

2 Furthermore, structural calculations are not  
3 research in this context. They are performed to meet  
4 safety and code requirements and ensure that the proposed  
5 design is structurally sound. Again, in this context, the  
6 calculations are more akin to quality control, which is an  
7 expressly excluded activity. Similarly, as to the alleged  
8 uncertainty that the firm could design a building that  
9 meets various code and other requirements, at most, this  
10 is activity consisted of routine engineering.

11 Appellants describe the ways in which they  
12 attempted to improve the energy efficiency of the  
13 buildings. This includes the aforementioned exterior  
14 screens as well as incorporating an internal courtyard  
15 garden and a rooftop garden. Appellants' credit study  
16 states that, quote, "The company researched whether there  
17 was a way to bring in more light thus, providing an energy  
18 savings on artificial light. After considering various  
19 options, the company determined that an internal courtyard  
20 garden that links all levels would allow sufficient light  
21 in to considerably decrease the amount of energy needed  
22 for artificial lights," unquote.

23 In other words, Appellants decided whether to  
24 incorporate an internal courtyard garden into the design.  
25 This describes more of a thought process than a process of

1 experimentation. The description also fails to identify  
2 genuine uncertainty or research in the laboratory or  
3 scientific sense. The same analysis applies with respect  
4 to the rooftop garden. Appellants describe the advantages  
5 of the use of a rooftop garden. This is shown on page  
6 1752 of the exhibit binder, which is page 45 of  
7 Respondent's Exhibit Q.

8           Nowhere in this description does Appellant set  
9 forth any activity that can be reasonably construed as  
10 qualified research with respect to a rooftop garden.  
11 Rather, Appellants state that out of the many alternative  
12 possibilities for a rooftop, they chose a rooftop garden  
13 and then described the advantages of a rooftop garden.  
14 The remainder of the alleged uncertainty with respect to  
15 the Brick & Machine Project, relates to the design of the  
16 parking garage. Appellants' research study states that,  
17 quote, "To avoid going too deep into the ground, the  
18 company researched options for space efficiency. To that  
19 end, the design team discovered that using stackable  
20 parking systems for each space would double the amount of  
21 parking without having to double the number of floors  
22 necessary," unquote.

23           Again here, Appellants describe a thought  
24 process, a choice, and the benefits of that choice. To  
25 the extent that making such a choice involves some

1 activity, Appellants have failed to substantiate that that  
2 activity was qualified research, and it failed to provide  
3 research documentation to support that activity.

4 Inserting the term research into the description does not  
5 convert an activity into qualified research.

6 In his declaration, Mr. Abramson more  
7 specifically states that the firm created a unique  
8 drainage and flooring system for the garage. However,  
9 here Appellants conflate the design process with the  
10 process of experimentation for a qualified purpose and  
11 have failed to articulate its actual activity  
12 constituting, quote, "Experimentation." Appellants have  
13 failed to describe qualified research and further failed  
14 to substantiate their claimed activity through  
15 documentation.

16 The Barker Project was for a design of a private  
17 residence. In their credit study, Appellants identified  
18 three uncertainties. Appellants claimed uncertainty in  
19 how to design the most energy efficient home possible,  
20 uncertainty in whether using alternative products could  
21 increase fire resistance, and uncertainty in how to create  
22 a house that would also function as a fire department  
23 staging area for emergency response.

24 With respect to how to design the most energy  
25 efficiency possible -- uncertainty. As noted earlier,

1       uncertainty under the Section 174 Test requires that the  
2       uncertainty relate to an advancement in technology or  
3       product concept. Here, the uncertainty identified by  
4       Appellants relates to the question of how are we going to  
5       put this together, which is a general uncertainty in  
6       designing anything.

7               Specifically, with respect to energy efficiency,  
8       Appellants identified certain elements that were part of  
9       their alleged process of experimentation. These include  
10      window glazing, cantilevers, a passive solar stone,  
11      reflecting pond, solar heat system, and air conditioning  
12      condensers. With respect to the window glazing for the  
13      Barker Project, Appellants claimed to have partnered with  
14      a fenestration specialist to model the solar heat gain  
15      coefficient. Mr. Abramson's testimony reveal that the  
16      firm simply selected a particular window with the help of  
17      a subcontractor. Appellants did not develop a new glazing  
18      or perform experimentation in the scientific sense.  
19      Appellants have failed to articulate what experimentation  
20      was actually conducted and have failed to substantiate  
21      their claimed research activity through documentation.

22              With respect to the window overhangs, Appellants  
23      allege that quote, "The company needed to design a  
24      solution for the issue of cooling around windows. Because  
25      the position of the sun changes throughout the year, as

1 does the desired heat gain, the company created  
2 cantilevers to shade the windows," unquote. The study  
3 goes on to describe that Appellants determined where the  
4 shadows would be using a computer generated shade analysis  
5 and designed overhangs that would block the sun at correct  
6 times of the year. This is shown in Respondent's second  
7 visual aid, which is available on page 1749 of the exhibit  
8 binder, page 42 of Respondent's Exhibit Q.

9 This visual aid shows a rendering of the  
10 overhangs that Appellants purport to have conducted  
11 research with respect to. Here, Appellants' purported  
12 research appears to have entailed choosing the desired  
13 length and perhaps the slope of the overhangs. Similar to  
14 the Brick & Machine Project, research expenses under the  
15 Section 174 Test require activity to eliminate uncertainty  
16 in the development of a product where development means  
17 some type of advancement in the concept of the product.

18 Here, again, it cannot be reasonably said, for  
19 example, that a cantilever that overhangs 5 feet at a 45  
20 degree angle represents an advancement or development in  
21 the Section 174 sense when compared to a cantilever that  
22 overhangs at a different length at a different angle. Of  
23 course, determining the length of a cantilever for a  
24 particular home may depend on numerous factors and  
25 considerations, like the screen example in the Brick &

1 Machine Project.

2           However, ultimately, these are just different  
3 choices of lengths and orientation. Abramson Teiger does  
4 not need to, quote, "Discover where the sun or shade will  
5 be." That information is shown. It simply needs to make  
6 a choice. Furthermore, using software to determine where  
7 to place an overhang does not change the non-experimental  
8 nature of the activity here. Appellants claim that,  
9 quote, "To further increase energy efficiency, Abramson  
10 Teiger architects included passive solar stone that would  
11 absorb and hold heat during the day and release it at  
12 night," unquote.

13           Passive solar stones have been used in this  
14 manner for a millennium, dating back to the Egyptians and  
15 is a well-known technique for energy efficiency.  
16 Mr. Abramson in his declaration on page 11 describes more  
17 specifically uncertainty in where and how much solar stone  
18 to incorporate into the building claiming, quote,  
19 "Abramson Teiger determined the passive solar stone used  
20 in limited amounts and at locations specifically  
21 calculated through experimentation to rule out the  
22 uncertainty," unquote.

23           However, this does not represent a genuine  
24 uncertainty in Section 174 sense. As described earlier,  
25 resolving uncertainty in the development of a product



1 requires some advancement in technology or a product  
2 concept. Here, there is no evidence that the placement or  
3 use of a solar stone in one location versus another  
4 location within the building represent an advancement in  
5 the product or concept of a solar stone. Appellants  
6 interpreted the term experimentation and uncertainty  
7 broadly to include consideration of any design decision  
8 that must be made. However, as a reminder, statutes  
9 granting tax credits must be construed narrowly.

10 Appellants have also failed to describe or  
11 provide any documentation substantiating the qualified  
12 process of experimentation performed with respect to the  
13 use of solar stones designed to eliminate uncertainty in  
14 improving the use of a solar stone to, quote, "Absorb and  
15 hold heat during the day and release it at night,"  
16 unquote.

17 With respect to the reflecting pond, Appellants  
18 state that the firm added a reflective pond in front of  
19 one of the larger windows so the design would benefit from  
20 the evaporative cooling of water. Nothing about this  
21 statement demonstrates uncertainty or a process of  
22 experimentation performed with respect to its use of a  
23 reflecting pond.

24 In paragraph 9 on page 12 of his declaration,  
25 found on page 1559 of the exhibit binder, Mr. Abramson

1 describes creating design alternatives to solve a fire  
2 rating problem. First and foremost, Mr. Abramson's  
3 declaration appears to describe a thought process for how  
4 the solution was arrived at as opposed to genuine  
5 experimentation. Mr. Abramson declares that quote, "After  
6 much experimentation, Abramson Teiger discovered that a  
7 closed denser cell polyurethane spray -- foam spray  
8 insulation provides hugely increased R values with less  
9 thickness. And unlike the alternatives, does not require  
10 a roof vent," unquote.

11 Appellants failed to explain precisely how this  
12 information was discovered through qualified research  
13 versus deducing it from an understanding of the product  
14 itself. Mr. Abramson further claims that the firm needed  
15 to conduct additional experiments to determine whether the  
16 insulation product could be used in the local is  
17 environment. Appellants' use of the term experimentation  
18 here is expansive. Determining whether a selected product  
19 will work for a specific project does not constitute  
20 qualified research or testing to resolve an uncertainty to  
21 improve or develop the product. It's akin to adaptation  
22 of an existing business component or quality control,  
23 which are nonqualified activities.

24 Finally, Mr. Abramson describes the firm's design  
25 work related to the driveway for the project. This

1 description again highlights Appellants' error in  
2 conflating the design process itself with a scientific  
3 process of experimentation. The mere fact that  
4 alternative designs were proposed before reaching a  
5 suitable design solution does not demonstrate Section 174  
6 uncertainty; does not establish satisfaction of the  
7 technological in nature test; and does not establish  
8 satisfaction of the process of experimentation test.

9 A scientific process of experimentation, as  
10 pointed in Union Carbide versus Commissioner, involves a  
11 series of trials to test a hypothesis, analyze the data or  
12 find the hypothesis, and retest the hypothesis so that it  
13 constitutes experimentation in scientific sense. It's not  
14 merely a simple method of trial and error to validate that  
15 a process or products change meets the taxpayer's needs.

16 The Sapphire Umeo Project involved the design of a  
17 residential home. Appellants identify uncertainty in how  
18 to design the most energy efficient home possible.  
19 Specifically, Mr. Abramson notes in his declaration that  
20 one challenge was due to, quote, "The client's unique  
21 design requirement that the exposed board and exposed  
22 concrete with large expanses of glass be used," unquote.  
23 Mr. Abramson states that the firm was uncertain whether it  
24 could achieve an energy efficient design.

25 Respondent directs the panel to Visual Aid 3

1 highlighting a portion of Appellants' credit study, which  
2 can also be found on page 1770 of the hearing exhibit  
3 binder. This excerpt describes the activity undertaken by  
4 the firm to resolve the alleged uncertainty and how to  
5 improve energy efficiency. As shown from this paragraph,  
6 Appellants were choosing the insulation material and  
7 researched insulation options. Finally, the company found  
8 a special insulation that had standoffs to be used in the  
9 project. As reflected in this paragraph, the purported  
10 research amounted to searching for and choosing among  
11 available options.

12 Mr. Abramson claims that tests were performed  
13 with respect to the concrete wall, however, also testified  
14 that Abramson Teiger did not perform these tests and have  
15 failed to provide any documentation substantiating any  
16 alleged testing. With respect to the claimed  
17 experimentation for the concrete wall, Mr. Abramson  
18 testified the firm engaged a contractor. However, again,  
19 those -- those tests had not been shown through  
20 documentation and were not performed by Appellants.

21 Appellants' amended return show that no contract  
22 research expenses were claimed for years at issue, which  
23 would be expected if the taxpayer engaged the contractor  
24 to perform qualified research. Appellants in  
25 Mr. Abramson's description of this project with respect to

1 removal screens, custom cantilevers, and design of a tract  
2 system also failed to demonstrate genuine uncertainty in  
3 the same manner as the aforementioned projects.

4 Mr. Abramson alleges that the firm, quote,  
5 "Studied, analyzed, and tested alternate air conditioning  
6 condensers from those traditionally used in residences."  
7 In other words, Appellants chose a commercial product and  
8 performed some activity to determine that the product  
9 would be suitable for the client's design. This activity,  
10 even if it were substantiated, is not qualified research  
11 as a matter of law. The firm's use of a particular air  
12 conditioning condenser in this instance relates at most to  
13 the adaptation of an existing business component, which is  
14 excluded from qualified activity under Treasury Regulation  
15 1.41-4(c)(3).

16 Moving on to the platform project. Platform  
17 project included a series of buildings in an urban renewal  
18 site, which included parking, retail, and office space.  
19 As shown in Appellants' credit study, as well as  
20 Mr. Abramson's declaration, Appellants claim to have  
21 engaged in qualified research in implementing the use of  
22 operable windows. Mr. Abramson specifically states that  
23 they considered quote, "Various alternatives for the  
24 installation of and size of operable windows to promote  
25 cross ventilation," unquote.

1 Appellants also claim to have engaged in research  
2 in creating a parking garage with natural ventilation.  
3 Renderings of the operable windows and naturally  
4 ventilating parking garage are shown in Respondent's  
5 Visual Aids 4 and 5 and also appear on pages 1767 and 1768  
6 of the exhibit binder which are Respondent's Exhibit Q,  
7 pages 60 and 61. As with the other projects, the activity  
8 described does not constitute development or improvement  
9 of a business component in the Section 174 sense.  
10 Furthermore, any purported experimentation in the  
11 scientific sense had not been substantiated.

12 The VBS Gym Project involved the design of a  
13 multiuse space to function as a gym, sanctuary, and  
14 performance center. Appellants' credit study identifies  
15 generic uncertainties, such as how to bring enough light  
16 into this space, how to design a multifunctional space,  
17 and how to adhere to earthquake code standards.  
18 Appellants' description of this project in Appellants'  
19 credit study, as well as Mr. Abramson's declaration,  
20 suffers from the same inadequacies as the previous  
21 projects described. First, the credit study reflects that  
22 Appellants' purported design process was more akin to a  
23 thought process than an actual process of experimentation  
24 for a qualified purpose.

25 Second, Appellants' description of the activities

1       they claim to constitute research highlight their  
2       conflation of the design process with the process of  
3       experimentation. Appellants failed to establish that they  
4       performed experimentation to develop or improve a business  
5       component as opposed to simply considering and then  
6       selecting among various known options. Mr. Abramson's  
7       statements describe choosing a roofing system and the  
8       reasons why the design used a truss system.

9               Finally, Appellants have failed to substantiate  
10       their claimed activities through research documentation.  
11       We heard from Mr. Abramson testimony about various  
12       experimentation that was performed, but Appellants have  
13       failed to substantiate its activity through research  
14       documentation. Furthermore, deciding that a screen should  
15       move is a great idea, but it is not a subject of qualified  
16       research. Appellants maintain that each project is  
17       entirely custom given the unique circumstances present by  
18       each site.

19               As Respondent has just described, Appellants have  
20       pointed to a collection of energy-saving features of the  
21       buildings and claimed this is evidence of qualified  
22       research. However, Appellants argument that the projects  
23       are entirely custom seriously undermines their ability to  
24       demonstrate satisfaction under substantially all  
25       requirement. Under the substantially all requirement,

1 Appellants must show that at least 80 percent of their  
2 claimed activity with respect to a business component  
3 constitutes a process of -- excuse me.

4 Appellants must show that at least 80 percent of  
5 their claimed activity with respect to a business  
6 component constitutes a process of experimentation for a  
7 qualified purpose. Appellants' assertion that the formula  
8 for producing a building is their business component is  
9 not supported by the statute or case law. Referring to  
10 the example in the Treasury Regulation regarding the  
11 development of an engine, Appellants' counsel stated,  
12 quote, "You don't take credit for the entire car, you take  
13 it for the hood," unquote.

14 Respondent similarly is saying, you don't take  
15 credit for the entire house, you take it for a specific  
16 component of the house. Therefore, under the  
17 circumstances, unless otherwise dictated, the taxpayers  
18 are bound by the regulations to identify discrete business  
19 components upon which research is performed. Appellants  
20 have failed to identify any discrete business components  
21 in this case. However, for the sake of argument, assuming  
22 for a moment that each project or building could be  
23 considered a business component for purposes of  
24 determining whether the substantially all requirements are  
25 met, Appellants must demonstrate that 80 percent of all



1     their designed activity constitutes a process of  
2     experimentation for a qualified purpose.

3             Since every design is entirely custom, the design  
4     activity includes the placement of every window, the  
5     configuration of every wall, roof, or door, the choice in  
6     what type of material to use, how thick to pour the  
7     concrete or what type of concrete to pour, the size of the  
8     courtyard, or how high the ceiling should be, the  
9     configuration of various spaces, how many levels of  
10    parking, and so forth. Every decision has to be made for  
11    every element of the project. Appellants must demonstrate  
12    that they engaged in a process of experimentation for a  
13    qualified purpose to resolve genuine uncertainty with  
14    respect to at least 80 percent of their time related to  
15    the business component.

16            As demonstrated, the business component, if not a  
17    discrete aspect of the building, is the entire project.  
18    Thus, even if Appellants could show that certain parts of  
19    the design entailed qualified research, which they have  
20    not, Appellants have also failed to demonstrate that 80  
21    percent of their activity with respect to these projects  
22    constitute a process of experimentation. Respondent  
23    reminds the Panel that things like determining which  
24    product will suit the project best or selecting among  
25    various option of sizes and similar activity, generally

1 does not entail a process of experimentation for a  
2 qualified purpose.

3 Under IRC Section 41(d)(2), the test for  
4 qualified activity, quote, "Shall be applied separately  
5 with respect to each business component of the taxpayer,"  
6 unquote. This means that 80 percent of the activities  
7 related to the project must involve process of  
8 experimentation meant to eliminate general uncertainty.  
9 Here, none of the evidence demonstrate satisfaction of the  
10 substantially all requirement. In fact, Appellants'  
11 hourly project record show that the firm has largely  
12 failed to satisfy this requirement. As explained today  
13 and set forth in Respondent's briefing, Appellants'  
14 architectural work is funded by its clients who either  
15 assume the risk under the contracts or retains substantial  
16 rights in the designs or both.

17 Appellant also have failed to show that the  
18 architectural designs overall should not be excluded as  
19 research in the arts. Appellants have failed to satisfy  
20 their burden to isolate the portion of their art design  
21 activity, but does not relate to aesthetics, taste, or  
22 other design factors. Appellants have failed to identify  
23 their business components and incorrectly applied the  
24 shrinking-back rule. Appellants have failed to describe  
25 activity satisfying the four-part test for qualified

1 research and have failed to substantiate their activity  
2 through research documentation.

3 For the foregoing reasons, Respondent's  
4 determination should be sustained.

5 Thank you.

6 JUDGE LONG: All right. Thank you, FTB. At this  
7 time I'm going to turn over to my co-Panelists to see if  
8 there are any questions for you.

9 I'll begin with Judge Lambert.

10 JUDGE LAMBERT: Hi. This is Judge Lambert.  
11 Maybe I could ask Appellant something. I was just  
12 wondering on the wages claimed. It looks there was a  
13 certain percentage that was identified for a lot of the  
14 wages as being a part of the research and the rest is  
15 non-research and development. And maybe, I was just  
16 wondering, if you could clarify what that activities  
17 performed were, or what were they that was not considered  
18 research and investment?

19 MR. MITCHELL: Yeah. Thank you, Judge.

20 So I think we went through a little bit in  
21 looking at Exhibit No. 32 in our initial part of this  
22 hearing. But the items that were excluded, it's included,  
23 for example, paid -- it starts with paid time off and  
24 various things that are not even research. And then from  
25 there the exclusion comes in and takes off interior design

1 work. We had a whole slide in our demonstrative that set  
2 out kind of the things that were specifically excluded,  
3 whether it was, for example, renderings of making  
4 drawings. It was interior design type of work.

5 Most of the things that Mr. Hall just described  
6 were actually on that list that were excluded. So I would  
7 refer you back to our demonstrative. There was a slide of  
8 the phases and the excluded phases, but it listed them on  
9 the excluded phases.

10 JUDGE LAMBERT: Okay. Thanks.

11 And so comparing the research and development  
12 architectural work that you are saying was done by  
13 Appellant, how would you compare that to -- what would you  
14 give example of as non-research and development  
15 architectural work? Would it be just something more basic  
16 or --

17 MR. MITCHELL: It is. It is, Judge. So time  
18 records, the IRS method for doing a study, the project  
19 method that we described is addressed at this very issue.  
20 And what it really looks at is when you have time records,  
21 engineers and architects put their time on projects for  
22 things that are challenging. Meaning, if something is  
23 simple, you're not logging in your time because it only  
24 takes a minute versus the things that take a long period  
25 time. You're putting your hours on the design phases that

1 we picked up.

2 And so the methodology for the study actually  
3 addresses that very issue of coming and excluding things  
4 that Mr. Hall kind of described in his presentation, and  
5 only picking up on those items that were largely related  
6 to the specific design challenges. And I'll get to that  
7 in a minute in my rebuttal.

8 JUDGE LAMBERT: This is Judge Lambert. Okay.  
9 Thank you very much.

10 MR. MITCHELL: Thanks for asking.

11 JUDGE LAMBERT: I have no more questions.

12 MR. HALL: If I could, Judge, I also noted to  
13 help Judge Lambert in response to his question with  
14 respect to activities not included, Mr. Abramson in his  
15 testimony at 1 hour and 41 minutes and 14 seconds begins  
16 to address a portion of what you're asking.

17 JUDGE LAMBERT: Okay. Thanks.

18 JUDGE LONG: All right. If that's all the  
19 questions from Judge Lambert, I'll turn it over to  
20 Judge Akopchikyan.

21 Do you have any questions?

22 JUDGE AKOPCHIKYAN: I don't have any questions.  
23 Thank you.

24 JUDGE LONG: All right. So then at this time, I  
25 wanted to offer, Ms. Alonzo, would you like a break before

1 we continue?

2 All right. And then Appellants' counsel, would  
3 you like a five-minutes recess before going into your  
4 rebuttal, or would you like to just go ahead and start?

5 MR. MITCHELL: I'd prefer to just go ahead and  
6 start so everybody can get on with their day.

7 JUDGE LONG: All right. Understood. You have 10  
8 minutes, and you may begin when you're ready.

9 MR. MITCHELL: Thank you, Judge.

10

11 CLOSING STATEMENT

12 MR. MITCHELL: So I have heard the arguments  
13 today, and I've read the briefs from the FTB. I've got to  
14 say, I don't think they understand the facts in this case,  
15 and I do think they're misconstruing the law.

16 So I would like to start with the case of Harper  
17 versus Commissioner. That's TC Memo 2023-57. Now, this  
18 case was not briefed because it came out after we  
19 submitted our briefs, but it addresses the business  
20 component. It's a similarly situated taxpayer. It's an  
21 architect and engineering firm. The IRS in that case  
22 specifically filed summary judgement arguing that a design  
23 is not a business component. It's the very thing that  
24 Mr. Hall is arguing today. Well, the Court in that case  
25 rejected that argument and said that a design actually can

1 be a business component.

2 And I think that's important because when you  
3 look at the shrink-back rule and how it's applied to the  
4 business component, that actually addresses pretty much  
5 every argument that Mr. Hall just made. Meaning, if you  
6 get off on the business component, which he is, he is  
7 coming in and trying to argue today that the taxpayer took  
8 the position that the whole project is the business  
9 component. We did not ever take that position. In fact,  
10 we have been consistent in saying that we use the IRS  
11 project method and shrank back to the specific business  
12 components.

13 And so, again, with time records, you're putting  
14 time on activities that are technical uncertainties. And  
15 so elements that don't require time, you're not recording  
16 time to. Meaning, you're recording your architect and  
17 engineer time on your timesheets for things that are  
18 difficult and challenging. And so by excluding those  
19 phases and categories, we have shrunken back to components  
20 that were being worked on. In addition to that, for the  
21 design elements we're talking about, we've provided  
22 numerous documents and evidence. I'll cover that in a  
23 minute.

24 But I'd like to talk about another court case  
25 real quick to help us understand and think about what the

1 research is here because I don't think the FTB understands  
2 it. So the case is Suder versus Commissioner, and that's  
3 TC Memo 2014-201. Now, this case involves a taxpayer who  
4 was creating phone systems for clients. So they basically  
5 were taking off-the-shelf phone components and combine  
6 them in different combinations and selling them as a new  
7 item to the clients. And the IRS in that case argued  
8 that, hey, this taxpayer is just combining items. There's  
9 no research here. It's all known. They're taking known  
10 components and putting them in order. They even said --  
11 the IRS even argued that the taxpayer in that case, their  
12 clients were just ordering off a menu, so the very same  
13 arguments that Mr. Hall seems to be making in this case  
14 today.

15 Now, the Court rejected all those arguments. And  
16 the reason why it did is it went through and said and  
17 reasoned that essentially the individual components may be  
18 known, but it's the combination of them, the interaction  
19 of all the components that is unknown. And because of  
20 that, the Court went onto say that the research in that  
21 case was qualified because there's unknowns involving the  
22 properties of the individual components that are put  
23 together to make a final phone, for example, office phone  
24 system. So that was deemed to be qualified.

25 Now, that's very similar in a way to what we have



1       here. When you look at the aspects of the design that we  
2       have, Abramson Architect and the taxpayers were working on  
3       multimillion-dollars large complex projects. They were  
4       tasked with coming in and coming up with designs that were  
5       energy efficient, structural sound, and had some other  
6       issues, like, drainage. So there was some uncertainties  
7       that had to be solved for each project that were unique.

8               But when Mr. Hall today cherry picks various  
9       items, like, screens and windows, those are all just  
10      components that go into the overall design. So like the  
11      Suder case, the taxpayer in this case had to actually  
12      consider a number of different components. They designed  
13      some of them themselves. Others were off-the-shelf. They  
14      did not manufacture them. But they had to put those in  
15      combination in conjunction in a way that would still solve  
16      the uncertainties with respect to the project. That's  
17      exactly what the Court said qualified said in the Suder  
18      case.

19             Now, I want to talk about a project just as an  
20      example. And I've got limited time, so I'm going to talk  
21      really fast. The Brick & Machine Project, you know,  
22      Trevor Abramson testified that that project involved a  
23      piece of real estate that could not be built upon because  
24      it was highly sought after area of the -- where it was  
25      located, but it couldn't built upon because there was a

1 parking issue. You couldn't put parking above ground  
2 because it was already built. You couldn't put  
3 underground because the water table was so high that water  
4 would fill up the underground structure, even when there  
5 is no rain.

6 So Trevor testified earlier in this proceeding  
7 that his final solution -- jumping ahead past the  
8 research -- final solution was a large three-story  
9 bathtub; so an underground three-story bathtub with a  
10 unique flooring system and draining system, and a pump  
11 system that was low energy. Now, as Trevor explained, the  
12 reason why that was required is because the unique  
13 circumstances of that property, everything that -- normal  
14 solutions that nobody else could come up with, those were  
15 all off the table.

16 You couldn't do what needed to be done, such as  
17 parking above ground, and nobody thought you could do  
18 parking below ground. But with this unique underwater --  
19 you know, underground three-story bathtub, that's not  
20 something that's known. That's not something that you  
21 read in a textbook. That's not something that can be  
22 known until you go through the iterations and do the  
23 analysis and come up with that design. Now, some of those  
24 parts of that design caused it to fail energy  
25 requirements, such as the pumps to continually pump water

1 out.

2 So Mr. Hall would point to the pump and say,  
3 well, you haven't shown that that's research. Well, where  
4 he's off is he's not understanding the business component  
5 is the design for the energy efficient building structure.  
6 And so all the components that are being considered in  
7 conjunction have to be looked at in the context of what is  
8 being done with that project.

9 Now, I'd also point out that it's interesting  
10 what the FTB is not addressing here. So the FTB has long  
11 taken the position that taxpayers have to have project  
12 accounting records. In fact, they routinely challenge  
13 taxpayers who take R&D credits when they don't have those  
14 records. Well, we have those records here, and the FTB is  
15 still making arguments about records. In fact, during his  
16 presentation, Mr. Hall went on about the Cohan Rule and  
17 McFerrin case. Well, we didn't have estimations in this  
18 case because we have project accounting records. So we  
19 don't need to rely on the two-step Cohan test. We  
20 actually mathematically have all the records to prove out  
21 exactly what the numbers are.

22 Now, the same thing applies with the shrink-back  
23 rule. Because the FTB doesn't understand the business  
24 component as set out in the Harper case, it's saying you  
25 haven't applied the shrink-back rule. Well, we have. In

1 fact, we used the IRS method for doing so. And so the  
2 method set out in the IRS briefing paper for capturing  
3 cost says that is the method that you tie expenses to  
4 activities for an R&D tax credit.

5 Now, we followed that method. And so the FTB  
6 today is arguing that that method doesn't deal with  
7 activities. But if you actually look at what is said by  
8 the IRS in its briefing paper, it does go to activities.  
9 It goes directly to activities. So everything that  
10 Mr. Hall said today on that is contrary to what is set out  
11 by the IRS in its own briefing.

12 Now, the FTB is still citing cases like the  
13 Little Sandy Coal case, and it's saying you haven't met  
14 the substantially all test, the 80 percent test. The  
15 Seventh Circuit said very clearly that that is to be  
16 applied on the shrunken-back business component. Since we  
17 were able to shrink-back, unlike the Little Sandy Coal  
18 case that the court said they didn't have records and  
19 couldn't shrink-back, we have those records in this case  
20 and did shrink-back.

21 So when you apply the 80 percent all test that  
22 Mr. Hall is arguing about today, that's applied to the  
23 shrunken-back business component. The Seventh Circuit  
24 says that in its opinion. So when you do that, the  
25 80 percent test is always met because we have

1       shrunken-back to qualified research.

2               Now, the FTB also doesn't address the Populous  
3       Holdings case or the Geosyntec Consulting case. Those are  
4       similarly situated taxpayers who do very similar work and  
5       were allowed credit. The FTB has not explained in any way  
6       why those taxpayers were entitled to credit for similar  
7       work when this taxpayer is not. Now, we have gone through  
8       the four-part test and explained how that's met. And  
9       for -- I would love to go through that again with you, but  
10      in the interest of time, we've identified the business  
11      components. We have addressed the 174 test, explaining  
12      that the taxpayers were not certain as to the appropriate  
13      design. And we've explained the process of  
14      experimentation, which is specifically set out in the  
15      project accounting records. So it details the phases and  
16      steps that were included and excluded in the -- and  
17      included in the R&D credit.

18              Now, the FTB has gone beyond existing law and is  
19      arguing today that there's not a four-part. There's  
20      actually a five-part test. And that five-part test, the  
21      fifth test is a copyright test that taxpayers have to show  
22      that their research meets copyright law. Not only is that  
23      not a law that exist on the books, the IRS made a similar  
24      argument in the Lockheed Martin case, and it was rejected.

25              Now as to the funded research issues, the FTB

1 seems to be confused about the retention of rights. On  
2 that issue, the contracts at issue are AIA contracts, and  
3 Mr. Hall posits that the AIA would never come up with a  
4 contract that puts rights or risk problems for their  
5 clients. Well, I can tell you I've talked to the AIA  
6 about these very contracts myself. And I can tell you  
7 that these contracts for the AIA were designed to allow  
8 their clients to take the R&D credit specifically. So  
9 Mr. Hall's contrary hazard statement is Just incorrect.

10 But setting that aside, if you look at the rights  
11 issue, the retention of substantial rights is not measured  
12 by the right to a design drawing. The law says it's the  
13 right to use the research results. So Mr. Hall is  
14 confusing contract terms that look to the ownership of the  
15 drawing, but it's actually what's depicted in the drawing.  
16 The question is, can the taxpayer use what it learned in  
17 that project in future projects. The question isn't, can  
18 he use the design drawings in a future project. And  
19 that's Mr. Hall's argument, which fails as a matter of  
20 law.

21 As to the second element on risk, Mr. Hall fails  
22 to note that the Geosyntec case, in that case the  
23 fixed-priced contract were specifically allowed, and the  
24 Court went on to only do this analysis of cost  
25 reimbursement contracts. But the FTB hasn't even argued

1       that these are cost-reimbursement contracts. That's a  
2       whole different type of contract. A fixed-priced contract  
3       is the one that calls for a lump sum payment. That's what  
4       we have here.

5               As far as Mr. Hall's arguments about additional  
6       services and the ability to charge for those, if you look  
7       at Exhibit 1, you'll see that we didn't pick up time for  
8       additional services because the study provider  
9       specifically did a funded research analysis and excluded  
10      time for additional services. So, again, Mr. Hall's  
11      argument there is without support.

12             Also, as to the burden of proof the OTA has  
13      regulations on points that say what a new matter is. And  
14      looking at the arguments that were raised in this case, so  
15      many new arguments. At some point, that many new  
16      arguments, that is a new matter. And those -- all those  
17      issues and sub-issues that the FTB raised, none of those  
18      were raised by the auditor. So what the FTB is arguing is  
19      they're arguing that the auditor should be reversed or not  
20      reversed on decisions that the auditor did not even make.

21             So for that reason, we would urge the OTA to find  
22      that the burden of proof is on the FTB in this case, and  
23      they haven't met their burden. Even if the OTA finds that  
24      the burden of proof is on the taxpayer, we have provided  
25      thousands of pages of documentation. We've provided

1 witness testimony. We are asking the OTA to find that is  
2 more than sufficient to document the R&D tax credits, and  
3 that the taxpayers have met their burden.

4 JUDGE LONG: All right. Thank you, Mr. Mitchell.

5 At this point, I'm going to turn over to my  
6 co-Panelists to see if we have any final questions before  
7 we close the record.

8 Judge Lambert, do you any final questions for  
9 either party?

10 JUDGE LAMBERT: This is Judge Lambert. I don't  
11 have any questions. Thanks.

12 JUDGE LONG: Judge Akopchikyan, do you have any  
13 final questions?

14 JUDGE AKOPCHIKYAN: One quick question for  
15 Mr. Mitchell. I didn't understand a point you're making,  
16 so I just wanted to ask you to repeat it. You're talking  
17 about the timesheet that engineers enter their time on the  
18 timesheet. What was the point you were making with that  
19 statement?

20 MR. MITCHELL: Yes, Judge.

21 So when you hire a professional like an architect  
22 or an engineer, they're going to put time on the project  
23 to do all aspects of the project. And when hire an  
24 architect or engineer, if they already know something --  
25 so, for example, they know how to design some aspect of



1 the project that's not new or novel to them, they're not  
2 going to put a bunch of time into their time records  
3 because they already know that. Meaning, they don't have  
4 to recreate the wheel.

5 So when you're doing an R&D credit study, and  
6 you're basing it on actual contemporaneous time records,  
7 you're already excluding the known items. So the FTB is  
8 here arguing that there are known items that -- that we're  
9 picking up in our credit study, and that's not case  
10 because those items don't make it onto the timesheet  
11 because they're already known. So the engineer or  
12 architect is not putting their time in. And we're  
13 computing our credit based on just on their time entries.

14 JUDGE LONG: Okay. Thank you. I understand your  
15 point, and I don't have a follow-up question. Thank you.

16 MR. MITCHELL: Thank you, Judge.

17 JUDGE LONG: All right. Well, let me ask a  
18 follow-up question, Mr. Mitchell. When somebody hires the  
19 firm to do something, you're saying that time spent on  
20 already -- on things they've done before, research that's  
21 already been done, things they've already figured out,  
22 that that information does not go on the timesheet.  
23 There's no time entered for that?

24 MR. MITCHELL: Yes, Judge. So think of it like  
25 an attorney. When you hire an attorney, if they already

1 have a work product developed, they can't charge their  
2 client for the same work. It's already developed. They  
3 already have it. So what you have is basically not time  
4 applied. You only have time being applied to challenges  
5 and technical uncertainties for things they don't know  
6 because they have to do the testing to figure it out.

7 JUDGE LONG: All right. Thank you. I think that  
8 concludes our questions.

9 All right. Let's see. Judges, do we have any  
10 final questions?

11 All right. Thank you.

12 With that, I think we're ready to conclude the  
13 hearing. I want to thank the parties for their  
14 presentations. The Panel of Administrative Law Judges  
15 will meet, and we will decide the case based upon the  
16 arguments, testimony, and the evidence in the record. We  
17 will issue our written decision no later than 100 days  
18 from today.

19 This case is submitted, and the record now is  
20 closed.

21 This concludes our hearing calendar for the day.  
22 Before we all go, I want to confirm were there any  
23 questions from either party?

24 MR. HALL: No questions from Respondent.

25 MR. MITCHELL: No questions, Judge.

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JUDGE LONG: All right. Great. Thank you  
everyone.

(Proceedings adjourned at 3:45 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 16th day  
of November, 2023.

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ERNALYN M. ALONZO  
HEARING REPORTER