

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
R. CALABRIA and C. STEWART,) OTA NO. 220911359
)
)
 APPELLANTS.)
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TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, April 25, 2024

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 10:30 a.m. and concluding at 10:45 a.m.
on Thursday, April 25, 2024, 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 JOHN JOHNSON ALJ LAUREN KATAGIHARA
For the Appellant:	KEVIN LAWRENCE
For the Respondent:	STATE OF CALIFORNIA FRANCHISE TAX BOARD PETER KWOK CHRISTOPHER DAVIS

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I N D E X

E X H I B I T S

(Appellants' Exhibit 1 was received into evidence at page 6.)

(Department's Exhibits A-F were received into evidence at page 7.)

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

	<u>P A G E</u>
By Mr. Lawrence	8
By Mr. Kwok	12

C L O S I N G S T A T E M E N T

	<u>P A G E</u>
By Mr. Lawrence	14

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California; Thursday, April 25, 2024

10:30 a.m.

JUDGE LONG: We are opening the record in the Appeal of Calabria and Stewart, OTA Case Number 220911359. This matter is being held before the Office of Tax Appeals. Today's date is Thursday, April 25th, 2024, and the time is approximately 10:30 a.m.

My name is Veronica Long, and I am the lead Administrative Law Judge for this appeal. With me today are Administrative Law Judges John Johnson and Lauren Katagihara. 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 Appellant.

MR. LAWRENCE: Kevin Lawrence, appearing for Renato Calabria and Carrie Stewart.

MR. KWOK: Peter Kwok on behalf of Respondent Franchise Tax Board.

MR. DAVIS: Chris Davis on behalf of Respondent Franchise Tax Board.

JUDGE LONG: All right. Thank you.

1 And as confirmed in the prehearing conference and
2 in my minutes and orders following that conference, the
3 issue to be decided in this appeal is whether Appellant's
4 have shown that they are entitled to a deduction for taxes
5 paid to a foreign jurisdiction on their California Tax
6 returns.

7 Next, I'd like to move to the evidence in this
8 appeal. Appellants submitted Exhibit 1, the Declaration
9 of the Italian accountant.

10 FTB, do you have any objection to Appellants'
11 exhibit?

12 MR. KWOK: No, Judge Long.

13 JUDGE LONG: All right. Hearing none,
14 Appellants' exhibit is now admitted and entered into the
15 record.

16 (Appellants' Exhibit 1 was received in
17 evidence by the Administrative Law Judge.)

18 JUDGE LONG: FTB submitted Exhibits A through F.
19 Mr. Lawrence, do you have any objection to FTB's
20 exhibits?

21 MR. LAWRENCE: No, I do not.

22 JUDGE LONG: All right. Hearing no objection,
23 FTB's Exhibits A through F are now admitted and entered
24 into record.

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

JUDGE LONG: Do we have any new exhibits today from either party? All right. Hearing none, I will go ahead and move forward.

So I'm going to go over the order of the proceedings today. In my minutes and orders I indicated that Appellants' presentation, including witness testimony, will be 25 minutes. And then FTB's presentation will be 15 minutes, and then Appellants' will have 5 minutes for rebuttal. Next, I believe Mr. Lawrence indicated that he intended to testify.

Mr. Lawrence, is that still correct that you'd like to offer witness testimony in this case?

MR. LAWRENCE: Yes, I do.

JUDGE LONG: All right. In that case, Mr. Lawrence, I'm going to go ahead and swear you in for witness testimony.

K. LAWRENCE,

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

JUDGE LONG: All right. Mr. Lawrence, you may

1 begin your presentation when you are ready. You have
2 25 minutes.

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PRESENTATION

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MR. LAWRENCE: Okay. Well, I'll first start with
my -- to address the Appeals Panel, and this is the
entry -- I'd like to make this introduction.

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I've been a CPA for 43 years, licensed in the
State of California, and a tax preparer in California for
the same time. I represented the taxpayer for the past 10
years. Renato Calabria is a noted Beverly Hills Board
Certified plastic surgeon. He's been in practice in
Beverly Hills since 1995. He is a naturalized U.S.
citizen. The taxpayers Renato Calabria and Carrie Stewart
have been married for 28 years and have filed jointly each
year. As part of his compliance with the federal and
State California tax laws, he reports all of his worldwide
income on his federal and state income tax returns.

During the periods under review, 2017 to 2020, he
operated an office in Milan, Italy. The income earned
from that office was reported on the taxpayer's federal
and State of California income tax returns as other income
on Line 21. The taxes paid to the entities, the State of
Lombardy and the City of Milan, were assessed as business
income taxes as they were paid by -- I'm sorry -- as they

1 were paid by Dr. Calabria to the State of Lombardy and the
2 City of Milan. They were based upon gross receipts, not
3 his net income.

4 The auditor in the argument -- the initial
5 auditor for the Franchise Tax Board used as his
6 controlling argument in his report, that the fact that
7 Renato Calabria and Carrie Stewart took a foreign tax
8 credit on their foreign tax on their -- on their federal
9 tax returns for each of the years in question precluded
10 them from reporting these taxes paid as a deduction on
11 their California income tax returns.

12 So that's my address. So I'm going to call
13 myself as a witness now. Okay.

14 Okay. So as I have prepared the tax -- I prepare
15 the taxpayers' returns. I reviewed Revenue & Taxation
16 Codes in my preparation. I reviewed Revenue & Taxation
17 Code 17220 and 24345-7. Those are the two codes, in my
18 opinion, that controlled this issue. They were cited.
19 Revenue & Taxation Code 17220 was cited by the Franchise
20 Tax Board as the reason for denying the deductions. I
21 believe that Revenue & Taxation Code 20 -- 17220 did not
22 apply because it was an exception noted in California
23 Regulation 24345-7, the definition of income tax B --
24 small (b) (1) and number (1) and realization number(2).
25 Therefore, I deducted these taxes as a difference between

1 the federal and the state income tax returns.

2 I made lot -- I -- in preparing the returns and
3 in my response to the initial auditor, who I do not know
4 and never heard from, it was a letter exam, basically.
5 And from that -- when I responded back on behalf of the
6 taxpayers, I made a great emphasis on the fact that
7 federal and -- federal law and California law always do
8 not -- always do not comply with one another. They
9 complement one another sometimes, but sometimes they are
10 totally different. They are different in many areas,
11 depreciation, pass through entity tax, Real Estate
12 professional deductions, and very importantly, gay
13 marriage. If you recall, California recognized gay
14 marriage many years prior to the federal government doing
15 so, and allowed taxpayers to file married filing joint as
16 when they were married in California.

17 In conclusion, I believe that the taxpayers were
18 entitled to this deduction. And if the Appeals Panel does
19 not agree with my presentation, I respectfully request
20 that all penalties be waived and abated for the tax years
21 in question, from 2017 to 2020, pursuant to the Revenue &
22 Taxation Code due to the fact that the taxpayer took a
23 reasonable position on their returns, and this was not a
24 case of willful neglect, as they reported all their income
25 and disclosed everything to the Franchise Tax Board.

1 That concludes my witness testimony.

2 JUDGE LONG: All right. Thank you.

3 Mr. Lawrence, does that also conclude your case
4 presentation?

5 MR. LAWRENCE: Could you repeat that, please?

6 JUDGE LONG: Does that also conclude your case
7 presentation? I just want to make sure before I move on.

8 MR. LAWRENCE: Yes, it does.

9 JUDGE LONG: All right. Thank you.

10 Franchise Tax Board, do you have any questions
11 for Mr. Lawrence regarding his witness testimony?

12 MR. KWOK: No. No, we don't, Judge Long.

13 JUDGE LONG: All right. In that case, I'm going
14 to turn to my Co-Panelists and ask if you have any
15 questions for Mr. Lawrence regarding his testimony or his
16 case presentation. I'll begin with Judge Johnson.

17 Do you have any questions?

18 JUDGE JOHNSON: No questions. Thank you.

19 JUDGE LONG: All right. And Judge Katagihara?

20 JUDGE KATAGIHARA: No questions.

21 JUDGE LONG: All right. I also do not have any
22 questions. With that, we are now ready for Franchise Tax
23 Board's presentation.

24 Franchise Tax Board, you have 15 minutes and may
25 begin whenever you are ready.

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MR. KWOK: Thank you, Judge Long.

PRESENTATION

MR. KWOK: As you mentioned earlier, the sole issue in this appeal is whether or not Appellants were entitled to deduct foreign taxes paid from 2017 through 2020. During the taxable years at issue, Appellants paid foreign taxes on income derived from business activities conducted in Italy. And aside from a few other minor adjustments, Appellants simply deducted the amount of taxes paid to the Italian government from their California gross income. During the four-year span from 2017 to 2020, Appellants deducted over \$450,000.

Respondent disallowed these deductions and assessed additional tax for each year during that period. For federal tax -- income tax purposes, Internal Revenue Code section 164(a) (3) allows a federal -- allows a deduction for income taxes paid -- foreign income taxes paid or accrued. However, California explicitly does not adopt, follow, or conform to this federal provision. In pertinent part, section 17220(a) of the Revenue & Taxation Code states the following: Section 164(a) (3) of the Internal Revenue Code relating to the deductibility of foreign income taxes shall not apply.

In this appeal, Appellants deducted the amount of

1 income taxes paid to the Italian government and reduced
2 their California gross income by over \$457,000. There's
3 no legal authority to support these deductions. And, in
4 fact, Appellants' reporting position is in direct
5 contradiction of the plain language of section 17220(a).
6 And for this reason, we ask that the OTA sustain
7 Respondent's action in full.

8 Thank you for your time, Judges. We'll be happy
9 to answer any questions.

10 JUDGE LONG: All right. Thank you.

11 I'll go ahead and turn it over to my Co-Panelists
12 for questions.

13 Judge Johnson, do you have any questions for
14 Franchise Tax Board?

15 JUDGE JOHNSON: I have a question for Franchise
16 Tax Board.

17 Appellant mentioned request for abatement of
18 penalties, if they don't succeed on the underlying
19 arguments. And, Franchise Tax Board, I was going through
20 the Notice of Action, but can you let us know, were there
21 any penalties imposed for the years at issue on appeal?

22 MR. KWOK: No, Judge Johnson, there were not.

23 JUDGE JOHNSON: Okay. Thank you. That's all.

24 JUDGE LONG: All right. Judge Katagihara, do you
25 have any questions for Franchise Tax Board?

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JUDGE KATAGIHARA: No questions.

JUDGE LONG: All right. I also do not have any questions. So I am going to turn it over to Mr. Lawrence for Appellants' rebuttal.

Mr. Lawrence, you have 5 minutes, and you may begin whenever you are ready.

CLOSING STATEMENT

MR. LAWRENCE: Yes. In reviewing Revenue & Taxation Code 24345-7, it talks about that that is an addition. That is a complementary code section of the California Revenue & Taxation Code to Code section 17220. It discusses the fact that business taxes, although not derived by income, because it precludes income, are deductible or if -- for foreign businesses reporting their income in California. Unfortunately, I believe that California Revenue & Taxation Code 24345-7 is pretty much outdated in relationship to today's economy because most -- you know, 70 percent of the economy -- and probably more than that in California -- are service-based businesses.

Service-based business is the only method of taxing service-based businesses is by attacking -- or not attacking -- but measuring their income as a measure of taxation -- utilizing their income as a measure of

1 taxation. They do not have large amounts of assets. They
2 do -- you know, maybe there's payroll, but usually, you
3 know, it's not the largest amount. So foreign
4 jurisdictions also have adopted this -- this method.

5 I'd like to bring up the fact that here in
6 Los Angeles, California, if Los Angeles, California was in
7 another country, the Los Angeles City business tax, which
8 is deducted by hundreds and thousands of businesses on
9 their California tax returns, would not be allowed under
10 Code section 17220 because it's a tax based on gross
11 income collected. So that's -- that's just my opinion. I
12 believe that 24345-7 should be utilized here more
13 liberally than it is being utilized. It does not reflect
14 today's economy. That's what I have to -- that's my
15 initial.

16 Thank you.

17 JUDGE LONG: All right. Thank you, Mr. Lawrence.

18 I'm going to turn it over to my Co-Panelists for
19 final questions.

20 Judge Johnson, do you have any questions for
21 either party?

22 JUDGE JOHNSON: No questions. Thank you.

23 JUDGE LONG: All right. Judge Katagihara, do you
24 have any questions for either party?

25 JUDGE KATAGIHARA: No questions.

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JUDGE LONG: All right. I also do not have any questions. With that, we are ready to conclude the hearing. I want to thank both parties for their presentations today.

The Panel of Administration Law Judges will meet and decide the case based upon the arguments, testimony, and evidence in the record. We will issue our written decision no later than 100 days from today. The case is submitted and the record is now closed.

This concludes our morning hearing calendar. The afternoon calendar will reconvene at 1:00 p.m.

Thank you.

(Proceedings adjourned at 10:45 a.m.)

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HEARING REPORTER'S CERTIFICATE

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

That the foregoing transcript of proceedings was 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 7th day of May, 2024.

ERNALYN M. ALONZO
HEARING REPORTER