

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
H. HOJATI and E. HOJATI,) OTA NO. 221212104
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 APPELLANTS.)
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Wednesday, October 9, 2024

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings,
taken at 12900 Park Plaza Drive, Suite 300,
Cerritos, California, 90703, commencing at
3:11 p.m. and concluding at 4:23 p.m. on
Wednesday, October 9, 2024, reported by
Ernaly M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: ALJ ASAF KLETTER

Panel Members: ALJ EDDY Y.H. LAM
ALJ JOSHUA LAMBERT

For the Appellant: H. HOJATI
STEVE MATHER
JAMES MATHER

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

PAMELA BERTANI
NATHAN HALL

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I N D E X

E X H I B I T S

(Department's Exhibits A-H were received into evidence at page 6.)

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	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>
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1 Cerritos, California; Wednesday, October 9, 2024

2 3:11 p.m.

3
4 JUDGE KLETTER: So let's go ahead and go on the
5 record.

6 This is Appeal of Hojati. It's OTA Case No.
7 221212104. Today is Wednesday, October 9th, 2024. The
8 time is 3:11 p.m.

9 I'm Judge Kletter. With me are Judges Eddy Lam
10 and Josh Lambert. While I'm the lead Administrative Law
11 Judge in conducting this hearing, all judges are coequal
12 decision makers.

13 Our stenographer Ms. Alonzo is reporting this
14 hearing verbatim. Please speak one at a time. Do not
15 speak over each other. Please speak clearly and loudly.
16 If needed, the hearing process may be stopped to ensure
17 proper transcription. And after the hearing, Ms. Alonzo
18 will produce the official hearing transcript, which will
19 be available on the OTA website. The hearing transcript
20 and the video recording are part of the public record.

21 Now, I'd like for the parties to each identify
22 yourself by stating your name for the record, beginning
23 with Appellant.

24 MR. MATHER: Steve Mather. I'm attorney for
25 Appellants. And appearing with me is Hamid Hojati.

1 JUDGE KLETTER: This is Judge Kletter. Thank
2 you.

3 And for Franchise Tax Board.

4 MS. BERTANI: Good afternoon. Pam Bertani
5 appearing for Respondent Franchise Tax Board. Here with
6 me is Nathan Hall.

7 JUDGE KLETTER: Okay. Great. And the issues
8 that we're hearing today, there are four of them. The
9 first issue is whether Appellants have substantiated
10 sufficient basis in their shares of ICC Collision
11 Center 1, Inc.'s, stock shares to allow the pass-through
12 loss that was reported on their 2017 tax return. The
13 second issue is whether Appellants have substantiated
14 losses from other pass-through entities that were reported
15 on their 2017 tax return. The third item is whether
16 Respondent's itemized deduction limitation adjustment was
17 erroneous. And the fourth item is whether Appellants have
18 shown reasonable cause to abate the late-filing penalty.

19 With respect to the evidentiary record, FTB has
20 provided Exhibits A through H. Appellant did not object
21 to the admissibility of those exhibits and, therefore,
22 these exhibits are entered into the record.

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

25 JUDGE KLETTER: Appellant has not provided any

1 exhibits.

2 Before we begin with the presentation, just a
3 quick reminder that there will be 75 minutes for
4 Appellants' presentation, inclusive of testimony,
5 75 minutes for FTB's presentation, inclusive of any
6 questions for the witness, and 5 minutes for Appellants'
7 closing statement and rebuttal.

8 And I'd also like Mr. Hojati, if you -- I'd like
9 to swear you in for your testimony. So if you could
10 please raise your right hand. I will swear you in.

11

12 H. HOJATI,

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

16

17 JUDGE KLETTER: Okay. And, Mr. Mather, are you
18 ready to begin your presentation?

19 MR. MATHER: Yes, I am.

20 JUDGE KLETTER: I just want to check with the
21 stenographer.

22 Were you able hear that?

23 THE STENOGRAPHER: Yes.

24 JUDGE KLETTER: Okay. Great. Thank you.

25 Mr. Mather, please go ahead, and you will have 75

1 minutes.

2

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PRESENTATION

4

MR. MATHER: Thank you.

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With respect to the first issue, which is the basis issue. This is essentially a timing issue. And the story starts with the audit of ICC 1, the corporation, at issue in this case. The Franchise Tax Board audited IC -- started the audit with ICC 1 and ultimately determined that there were no changes to be made to the entity's return but then flipped over and decided to adjust or disallow part of the flow-through loss on the personal return of the taxpayers. Since the story starts with the entity return, you can kind of get the explanation of what really happened in this case and why we believe there's basis by looking at the partnership return -- or at the entity return, the ICC 1 return itself, which is Exhibit A in our -- in our record.

In 2017 ICC 1 changed painting contractors. And as part of that change, the new paint contractor provided a -- there was a new contract, and part of that contract was that there was a million-and-a-half dollar -- what Mr. Hojati refers to as a rebate. It's essentially a deposit that's paid by the new paint contractor, and it is earned out over the life the contract. So that if the --

1 if ICC 1 and its related entities acquires enough paint
2 from the paint contractor, the deposit or rebate is
3 essentially forgiven. So that's -- that's -- that
4 million-and-a-half dollars went into ICC 1 in 2017.

5 And the way that we can really see that is on
6 Exhibit A, page 5, in the balance sheet Schedule L. On
7 line 15 the accounts payable for that for the year went
8 from \$259,664 to \$2,097,025. That increase is large -- is
9 almost entirely attributable to the million-dollar paint
10 deposit. I'll call it a deposit. And it was accounted
11 for as a liability as I said because it was -- it was
12 refundable if -- if they didn't meet the criteria for
13 purchasing enough paint. So as I said also, the ICC 1
14 return was audited by Franchise Tax Board, and there was
15 no challenge made to the characterization of that amount
16 as a liability, not as some form of advanced payment of
17 income.

18 So what happened to that liability? Or what
19 happened to that \$1.5 million? Well, we can see that also
20 on the balance sheet of the tax return, again, on
21 Schedule A, page 5 -- or Exhibit A, page 5, Schedule L on
22 line 13. And -- and also in the supplementary schedule on
23 page 35 of Exhibit A, there's an increase in the amounts
24 due from affiliates. So ICC 1 was one of at least three
25 operating companies that were in the body shop business at

1 the time, and some of this \$1.5 million was passed on to
2 the other members of the group, who are also part of the
3 contract. And their -- their purchases under the contract
4 would help earn out the \$1.5 million.

5 So the amounts there are the ending balance was
6 \$1,435,628, and the beginning balance was \$1,002,277,
7 leaving an increase in the amounts due from these
8 affiliates or conversely amounts that were paid to the
9 affiliates during the years of \$433,351. So that's part
10 of the million-five. Another part of the million-five was
11 an amount that was paid to the old paint company. The old
12 paint company had a similar arrangement where the earn out
13 had not occurred as a result of terminating the contract
14 early. And so the old paint company had claims against
15 ICC 1 to return part of this deposit or rebate amount.
16 And we could see that during 2017, an amount of
17 approximately \$450,000 was paid to the earlier paint
18 company because, again, in Exhibit A, page 5, Schedule L,
19 line 17, and the subsidiary schedules on page 43, there's
20 an expense listed for legal settlement of \$1,450,306.

21 And then on page 39 in the subsidiary schedule
22 for the other liabilities there's a million-dollar payable
23 still listed. So that difference -- if I didn't mention,
24 that's on page 39. So that difference of \$450,306 were
25 the amounts that paid down the legal expense that was --

1 the legal settlement expense that was accrued during the
2 year down to the ending balance that still remain to be
3 paid of a million dollars, which was actually paid the
4 subsequent year. So that covers about \$900,000 of our
5 million-five of deposit.

6 And then the other part was the -- just funding
7 the loss that ICC 1 occurred -- incurred during the year.
8 The total loss, which was on Schedule F, line 22 of
9 Exhibit A, was \$2,408,413. We know there was the
10 \$1 million legal payable that we just saw. There was also
11 a paint master payable of \$227,000, and increases in
12 accounts payable unrelated to the million-five of \$337,361
13 that we discussed above. And the other balance sheet
14 items involved a use of cash of approximately \$200,000.
15 And so the remaining \$640,000, give or take, was funded of
16 loss -- the actual cash loss incurred by ICC 1 during the
17 year was funded by this \$1.5 million -- million deposit
18 payment.

19 So what is the deposit payment? Well -- and --
20 and I'll let Mr. Hojati explain this more because he's the
21 one that's familiar with it.

22 But, essentially, this is a liability that
23 Mr. Hojati was personally liable for. And so in the basis
24 schedule and determination by the Franchise Tax Board,
25 there is no accounting for the million-five of personal

1 liability Mr. Hojati incurred with respect to this new
2 deposit that essentially funded the loss that then flowed
3 through to his return. So the basis is created by this --
4 by this personal liability or obligation that Mr. Hojati
5 incurred, the money of which was paid into the corporation
6 to -- and used for the purposes that I mentioned.

7 So with respect to the second issue, this is --
8 this is kind of an extraordinary issue, in my experience
9 at least, because it appears -- we had a difficult time
10 figuring out what it was. But what appears that happened
11 is the Franchise Tax Board, when they -- when they did
12 the -- when they flipped the audit from an ICC 1 audit to
13 an audit of the Hojati's personal return, they didn't have
14 a complete copy of the 540. So in doing -- I guess just a
15 tick and -- cross footing sort of practice, they looked
16 at -- they realized that there was not a schedule in the
17 copy that Franchise Tax Board had of the Schedule E K-1s
18 that had been reported by the clients -- or by the
19 taxpayers. So they added up the K-1s. From what I
20 understand, they added up the K-1s that they could find,
21 and there was a difference.

22 And what we believe is the difference is, if you
23 look at Exhibit C, page 3, which is a representation of
24 what their -- how the FTB determined their number. They
25 list six pass-through items, including the ICC 1 that was

1 the genesis of the basis question. But what's -- what's
2 missing from these, we know for a fact with respect to the
3 first one, Arizona State Commercial Properties, LLC, is
4 that -- and -- and also, we believe with respect to
5 California State Commercial, those are partnerships that
6 were partnerships with Mr. Hojati and Mrs. Hojati. And
7 what the Franchise Tax Board has listed here, certainly
8 under Arizona, is just Mr. Hojati's K-1.

9 So we -- we believe what happened here is they
10 looked for the K-1s issued for Mr. Hojati in attempting to
11 reconcile the number on the joint return and failed to
12 pick up the K-1s for Mrs. Hojati. Mrs. Hojati's K-1 for
13 that year as \$23,718 of loss on the Arizona State
14 Commercial Properties, LLC, which -- because she was 50
15 percent owner, and there was a \$1 rounding difference. So
16 that does not appear in the FTB's schedule, and it appears
17 that that was the source of the problem when FTB, using
18 this partial return, attempted to reconstruct the
19 Schedule K.

20 We know that Mrs. Hojati had to have an interest
21 in California State Commercial Properties because it was a
22 partnership, and there's no other owners other than the
23 husband and wife. So -- so we don't have a copy of that
24 K-1. We -- we did not locate that return. But based on
25 the fact that the Arizona one had that -- that other

1 50 percent K-1, we think Mrs. Hojati's interest was
2 probably not 50 percent in the California entity. But it
3 was certainly something because it was a partnership, and
4 they were the two partners. So -- so it's kind of
5 remarkable in that FTB is essentially proposing an
6 adjustment because they don't have in their own files a
7 copy of the taxpayer's tax return -- or a complete copy.

8 So that, to me, is just an inappropriate
9 adjustment in the first place, but there is an
10 explanation. And if you look at Exhibit B, page 20, you
11 can, in fact, see that in the reconciliation on the pages
12 of the tax return that FTB did have, Mrs. Hojati had
13 pass-through losses of \$297,845 that were claimed which --
14 from -- from partnerships which suggest that maybe she
15 was, in fact, a 50 percent partner in the California
16 entity because Mr. Hojati has the exact same amount of
17 flow-through losses reported on this return from his own
18 K-1s. So it appears that the whole reconciliation of this
19 amount is attributable to the fact that FTB had a partial
20 return. They didn't understand that there were K-1s from
21 Mrs. Hojati and, therefore, didn't include Mrs. Hojati's
22 K-1s in the schedule that they provided.

23 So with respect to the third issue, the itemized
24 deductions, we think that's just a computational issue.
25 So that, you know, if -- depending on what the other

1 adjustments are, then the computation will kind of take
2 care of itself.

3 So the last issue is the late-filing penalty.
4 And Mr. Hojati used a Mr. Arora, who is an enrolled agent,
5 to prepare his entity returns and his personal returns for
6 over 30 years -- 35 years. But close to 30 years by the
7 time the 2017 return was filed, and Mr. Hojati was told
8 that the returns were filed on time. He knew there was
9 extensions. He was informed by Mr. Arora that they were
10 file on time. Never in the preceding 30 years had that
11 caused any delinquency in filing, and there was no reason
12 for Mr. Hojati to doubt that.

13 But, seemingly, based on the Franchise Tax
14 Board's information, at least, the return was filed a
15 couple of months late, and we don't know why. Mr. Arora
16 had a heart condition. He isn't available to testify.
17 So -- but we know what Mr. Hojati knows, which he was told
18 it was filed on time. And that had, as I said, been the
19 practice for decades before this year. So we -- we
20 believe that the representation for Mr. Arora that the
21 returns were filed on time, at least constitutes
22 reasonable cause for Mr. Hojati believing that the returns
23 were filed on time, even -- even if it turns out that they
24 were not.

25 So that concludes my opening remarks, and I'll

1 turn to Mr. Hojati, unless the Panel has any questions
2 before we move on?

3 JUDGE KLETTER: You can please proceed.

4 MR. MATHER: Okay.

5

6 DIRECT EXAMINATION

7 BY MR. MATHER:

8 Q So, Mr. Hojati, what's your educational
9 background?

10 A My educational background is --

11 JUDGE LAM: This is Judge Lam speaking. Can you
12 please speak into the mic for us. Thank you.

13 MR. HOJATI: I have a bachelor's degree from
14 Long Beach State University.

15 BY MR. MATHER:

16 Q Briefly describe your -- your work history?

17 A I was in a body shop business. I'm retired now,
18 and I'm not in the body shop business anymore.

19 Q So how many body shops did you have at -- or
20 describe the history of it. When did it -- did it start
21 with one and grown with others?

22 A It started with one, and I expanded because we
23 had a deal with the insurance company, and I expanded to
24 all the -- to all the areas. I start from LA, and I end
25 up in Arizona, and we had couple of locations in Arizona.

1 Q And what was the location for ICC 1?

2 A ICC 1 was in Santa Ana, I think -- I believe.

3 Q There's multiple ICCs; is that right?

4 A Yes, there is.

5 Q So how did ICC 1 become ICC 1? Was there
6 something before ICC 1?

7 A So it was always a body shop. So I started from
8 Culver City. It was -- I don't know what we call it, but
9 it was Alpha Motors and we -- we did it at their -- we
10 opened the corporation, I believe, in 2009 or 2010. So
11 I'm not -- I'm not sure about the dates.

12 Q So was -- was -- were the body shops -- the
13 different body shops all in one entity ever, or were they
14 always a separate entity?

15 A So it was always in one entity, and we -- we
16 separated all of them, basically, based on the corporation
17 that they had. But the DBA name was the same. It was a
18 different corporation, but the DBA was the same.

19 Q So at some point, it switched from all of the
20 shops being in one entity to all of the shops being in
21 their own separate entity?

22 A Yes. Yes.

23 Q And that's when ICC 1 started?

24 A Yes.

25 Q So what was -- what was contributed to ICC 1 when

1 that split occurred?

2 A ICC 1 was in a body shop business. We were
3 getting cars from the insurance company, and we would fix
4 cars. And they had a lifetime warranty when it was
5 referred by the insurance company, and that was it.

6 Q So was there equipment in the Santa Ana location
7 that transferred in to ICC 1?

8 A Yes. There was equipment. We always shifted the
9 equipment from one location to another. And this was done
10 probably midyear or for the -- or the following year. It
11 was done in July or December.

12 Q So when ICC 1 started operating as ICC 1, what
13 assets did it have?

14 A It had some assets. We didn't take the asset
15 inventory, but it had some asset. Obviously, we had to --
16 we had a frame machine, and we had a paint booth to paint
17 the cars, frame machine to pull the cars, and we had -- I
18 think the asset was about a million dollars in each shop.
19 So the assets wears out after you use them. So we would
20 repair them. Or if it wasn't repairable, we would replace
21 them with some other assets.

22 So, basically, it was -- it was -- we had some
23 assets in the -- in the company. So it was about
24 \$3 million worth of assets between --

25 Q Three -- three mil -- oh.

1 A -- all the locations. Three million, yes. So
2 between all the locations, we had \$3 million in assets.

3 Q And so those -- so a million or so of those
4 assets were transferred into ICC 1 --

5 A Yes.

6 Q -- when ICC 1 started?

7 A Yes, it was.

8 Q Now, the Franchise Tax Board's computation of the
9 original contribution is that it was \$5,000 in cash and
10 that's it. Is that --

11 A No. \$5,000 was the deposit for starting a
12 corporation. But the asset, as I told you, I never took
13 inventory of the assets. So the assets was extra on top
14 of what we were paying for creating a corporation for each
15 location.

16 Q So in my opening statement I mentioned paint
17 contracts. Can you explain how paint contracts work for
18 ICC 1?

19 A So paint contract -- the paint companies, they
20 usual pay us prebates. So what prebate means is --

21 Q Wait. I'm sorry. Is that rebate or prebate with
22 a "P"?

23 A We call it rebate, prebate, so it all depends.
24 If we call it a rebates they -- they pay upfront fees,
25 one-and-a-half million dollars, basically, and it was a

1 split between the locations. So ICC 1, I think, got the
2 most money, and it's split between six -- we had six
3 location at a time. So the paint company was very
4 attractive to us, and they were -- and we were attractive
5 to them, basically. And we -- we owe them money to -- to
6 get the company.

7 So they -- we give them a prebate of five years.
8 So five years, let's say it was \$10 million that we had to
9 buy the paint. So the prebate means they would pay us
10 one-and-a-half-million dollars, and we had to buy 5 years,
11 \$2 million a year, paint from them between the locations.
12 So that's what it means.

13 Q So it if you did buy \$2 million of paint, what
14 happened to the prebate amount?

15 A So they would discount at the end. So it was a
16 five-year rebate program, and we would -- they would
17 calculate it themselves based on all the purchases. So
18 they would say you've bought from \$2 million per year, you
19 bought one-and-a-half million dollars, and they would --
20 they would push it to the next year. So we wouldn't pay
21 them money back, but they would pay it -- they would
22 extend the time.

23 Q So -- but if you got to the end of the contract
24 and you hadn't bought \$10 million of paint, then what
25 happened?

1 A So we had to pay it back at that time. So
2 that's -- that's how the rebate works.

3 Q Okay. Now, you mentioned six stores. So was
4 that -- at what point in time was that? Was that in 2017,
5 or was it an earlier contract?

6 A It was, I think, it was earlier contract. 2016
7 we added one more location, which was -- which was one of
8 the -- I want to remember that this was years ago. 2017
9 added one location, and it was in Koreatown. And so we
10 added ICC 6 to one location.

11 Q Okay. Now, was there any restriction on how the
12 ICC companies could use this prebate, this \$1.5 million?

13 A So we had to buy all the paint and all the --
14 whatever was necessary to bring the car from one -- one
15 customer, one jobber. So I think it was something in that
16 regard. Master -- I don't handle day-to-day operation.
17 That's why I don't know it. But it was -- it was handled
18 like this. So the paint was purchased from one location,
19 and we had to exclusively buy from them only.

20 Q Now, did you change paint contracts in 2017?

21 A Yes, I did.

22 Q And describe what happened.

23 A So we -- we had a paint company that paid us a
24 million dollars, and they paid us based on locations that
25 we had. So another paint company approached us and told

1 us they're going to give us more money to give us to -- if
2 we buy exclusively from them. So we switched them from
3 \$1 million to \$1.5 million. I think the paint company was
4 DuPont.

5 Q The old one or the new one?

6 A The new one.

7 Q And who was the old one?

8 A The old one was Axalta.

9 Q How do you spell that?

10 A A-x-e-l-l-a [sic], I think.

11 Q So what -- what happened with the old paint
12 contract then, if you terminated it?

13 A So we paid back the old company, the paint
14 company. I think it was a settlement that was issued, and
15 they had a UCC filing on the business and me personally.
16 And they took that off, and we wired \$1 million to them.

17 Q And what year was the payment made? Do you
18 recall?

19 A I think the payment was made 2018 after we got
20 the money.

21 Q Okay. But you received the paint. The new
22 \$1.5 million, was that in 2017 or 2018?

23 A In 2017 we were in negotiation. It took a long
24 time for us to negotiate on what we had to pay back. So
25 it took us eight months for negotiation.

1 Q For negotiation on the pay back to the old paint
2 company?

3 A To the old paint company, yes.

4 Q And what -- what liability did you have on this
5 new paint contract?

6 A So as far as I'm concerned I owed it. I owed the
7 money to the old paint company, new paint company. So
8 it's my liability.

9 Q And you say as far as you were concerned, why did
10 you think that?

11 A It was -- I never -- I own the company
12 100 percent. My wife also owns it, but I own 100 percent
13 of it. And whatever that we made we -- we paid back. We
14 pay. I don't like to owe anybody any money. So I paid
15 everything back to the paint company, if it was a paint
16 company. If they said to buy it from this jobber, we
17 bought exclusively from that jobber only.

18 Q So but did DuPont on the new paint contract, did
19 they insist that you be liable personally?

20 A Yes, they did.

21 Q And was that okay with you. I mean --

22 A It was part of what they had to do. I mean, so
23 it was my liability. So I knew that from the beginning,
24 yes.

25 Q And so in my opening remarks I mentioned that

1 due -- the amount due to ICC 1 from affiliates went up
2 during the course of 2017? Do you remember why that was?

3 A So it was because the paint company paid us. The
4 new paint company paid us money, one-and-a-half million
5 dollars, and we paid back the old company. So that's
6 where the million dollars come from.

7 Q Right. But the excess, some of the excess
8 was that -- where did that go?

9 A Well, we put everything into the company. They
10 wire all the money to the company only. So when I say
11 company, it's me, and they wired the money to me because
12 it was -- it was all my company. I mean, ICC 1 was my
13 company. So I don't know what I'm being asked. So --

14 Q Now, I'm -- I'm handing you Exhibit A from the
15 record in this case. Do you recognize what this is?

16 A Exhibit A, so this looks like a tax return.

17 Q For who?

18 A It says for ICC Collision Center.

19 Q ICC 1; correct?

20 A ICC 1, yes.

21 Q So turning to page -- this isn't unsigned -- or
22 unsigned return, but turning to page 3 of Exhibit A, could
23 you read who the preparer is?

24 A Jagjit Arora was my accountant.

25 Q So describe your relationship with Mr. Arora?

1 A So my relationship, I trusted Jay for a long
2 time. So he's been my accountant for 35 years. So I
3 trusted them. Whatever he said to sign, I signed it.
4 So --

5 Q So this is a return for the company, and so
6 Mr. Arora prepared the company returns also?

7 A Yes. Yes, he did.

8 Q And when do you think he started that? When did
9 he first start doing your tax returns?

10 A I always got an extension on April.

11 Q No. But I mean, which years -- I mean, how many
12 years? You said it was 30 years or -- approximately?

13 A Yeah. 30 years -- it was 35 years he was my
14 accountant. Yes.

15 Q So that makes it 1990, or something like that?

16 A Something like that. Yeah.

17 Q Okay. And -- and so for all that time he
18 prepared -- whatever entity you had, he prepared the
19 entity tax returns?

20 A Yes, he did.

21 Q Okay. And then turning to Exhibit B, this is
22 your personal return. And also on page 5 of Exhibit B,
23 Mr. Arora --

24 A Mr. Arora did my personal returns.

25 Q -- your personal return.

1 A Yeah.

2 Q And so all through that 30-plus year period, he
3 also did your personal returns?

4 A Yes, he did.

5 Q Now, do you remember any discussion in 2017 with
6 Mr. Arora where he indicated that you didn't have enough
7 basis to claim the loss from ICC 1?

8 A No, I didn't. No. Yeah. No.

9 Q So, I mean, you aren't computing the basis, I
10 assume, by yourself; right?

11 A No, I'm not.

12 Q But Mr. Arora had all of the information --

13 A Yeah.

14 Q -- for the entity and for you personally?

15 A Yeah. He would say, if I had to pay something as
16 far as taxes. Basically, he was my accountant for a long
17 time. So I trusted him.

18 Q And do you remember him explaining to you for
19 2017 anything about whether the returns would be filed on
20 time or late or anything like that?

21 A So as I told you he, he always filed an extension
22 for my return -- for business returns, but I knew he was
23 always filing on time when it was the extension time. I
24 think it was October or September. Business was first
25 then it would have been my personal one month later. So

1 he -- he -- he said he did it. So -- and everything was
2 transmitted electronically. So I -- I don't know what he
3 did.

4 Q Do you know if it was transmitted electronically
5 in 2017?

6 A Yeah. Yeah. All the businesses was -- was
7 transmitted electronically.

8 Q And the personal return too?

9 A Yeah. Sometimes --

10 Q I'm sure that's what's done now, but are you sure
11 that it was done in 2017?

12 A Yeah. Yeah. My personal, right?

13 Q Right.

14 A Yeah. Yeah. It was done.

15 Q And so what did he tell you about transmitting
16 the return?

17 A He said it was accepted by whatever agency he was
18 transmitting it to. So whether it was the IRS -- I don't
19 know the history of what's going on, who do they transmit
20 it to, but my accountant said he transmit it, and it was
21 accepted. So I would take his word for it.

22 Q And in the 30 or so years before 2017 -- 25 years
23 maybe -- had you ever had a situation where the return was
24 not filed on time?

25 A No. Never. Never had a return filed late. I

1 mean, I would -- I would get something in the mail. So
2 that's how I was checking him just to make sure that
3 everything is filed. So I got nothing through the mail
4 either. So he said it was accepted, and that would be the
5 end of it. So I don't know if they would contact him if
6 it was rejected or something.

7 Q So the Franchise Tax Board says that the returns
8 were actually filed a couple of months -- two-and-a-half
9 months late. Do you have any explanation for that?

10 A I have no explanation, but I know I signed it on
11 time. So if he transmitted electronically, I have no idea
12 if he did it or not. So --

13 Q Did he ever tell you that there was a problem
14 with getting it accepted electronically?

15 A No. No. Everything was getting accepted. So he
16 always said it was accepted.

17 Q So is it -- is it fair to say that in the whole
18 history of the time that he prepared your returns he
19 never -- every time you asked him, he told you the returns
20 were filed on time?

21 A Yes. Yes.

22 Q And 2017 was no different?

23 A No different. This is news to me that it was
24 filed late. So I have no idea.

25 Q Now, I referred to, in my opening comments, to

1 Exhibit C, page 3, and there's a list of six entities in a
2 schedule at the top of that page. Do you recognize the
3 names of those entities?

4 A So some of them I do. So this is the body shop,
5 right, all of them?

6 Q They're all pass-through entities, S corporations
7 or partnerships.

8 A Oh, that's corporation. Okay.

9 Q So what's -- ICC 1, I guess we didn't know is the
10 company in this case; right?

11 A Yeah.

12 Q What's ICC Collision Centers?

13 A ICC Collision Center is the shop we opened in
14 Orange County, I think.

15 Q Or maybe Arizona? Is that the --

16 A So in -- in Arizona we had two locations in
17 Arizona, and we opened Arizona Commercial Property.

18 Q And so what did Arizona State Commercial
19 Properties -- what was its business?

20 A It was a body shop business.

21 Q Was it the operating entity, or was it the entity
22 that owned the property?

23 A No. It was the entity that owned the property
24 also. So it was under ICC Collision Center, but
25 everything was -- was owned by me and my wife, so for both

1 California and Arizona.

2 Q So those were partnerships?

3 A Yes.

4 Q And the two of you were partners?

5 A Yes.

6 Q And then ICC 6, did you say that was Koreatown?

7 A That was Koreatown, yes.

8 Q So the ICCs, as I think you mentioned before,
9 have a different corporation for each location; right?

10 A Yes.

11 Q What is Apex Management?

12 A Apex Management was the managing company that
13 was -- it was a different company. So Apex was the
14 management company for all the body shops.

15 Q So it -- it appears from the schedule that all
16 the body shops had losses that year, all the ICCs?

17 A Yes. Yes, it did. So that's why we closed it.

18 Q But the -- just so I'm clear -- that the Arizona
19 State Commercial Properties and California State
20 Commercial Properties owned the real estate. What did
21 they own?

22 A Owned the real estate in Culver City in
23 California, and owned the real estate in Arizona also.

24 Q So those -- that real estate was the real estate
25 where the body shops were located?

1 A Yes. Yes.

2 Q Okay. Those are the entities that were
3 partnerships with you and your wife?

4 A Yes.

5 Q And so if you and your wife were both partners,
6 would you each have received K-1s?

7 A Yeah. I mean, the accountant is supposed to file
8 it. He said the best way to do it is to have a
9 partnership, and I give him okay to -- to give a
10 partnership. So --

11 Q Could it have -- could it have been a partnership
12 if you were the only owner?

13 A No. I -- I was married 30 years ago. So I know
14 in California and in Arizona, whatever I have, it belongs
15 50 percent to -- to her and 50 percent to me.

16 Q So making her 50 percent partner just makes
17 sense?

18 A Makes sense. Yeah. Yeah.

19 MR. MATHER: I have no further questions, and
20 that concludes our opening.

21 JUDGE KLETTER: Thank you.

22 This is Judge Kletter. Just a couple of
23 questions that I have, and I'll check with my Panel if
24 they have any questions. I just want to clarify some
25 things that were mentioned earlier. So you had mentioned

1 that for Arizona State Commercial Properties that there
2 was a K-1 that was issued. Is that in the record? Or,
3 you know, one of the -- I think you were showing on one of
4 the exhibits that there was an amount that indicated that
5 there was a 50 percent ownership, but is there a K-1 in
6 the record of Arizona State Commercial Properties?

7 MR. MATHER: It's not in the record. We just
8 located the return today. That's how I -- that's how I
9 know there was a K-1, but it was past the deadline to
10 submit as part of the record.

11 JUDGE KLETTER: Okay. And then my other question
12 is actually for Mr. Hojati. On page 2 -- sorry -- 3 --
13 let me make sure I have the page correct.

14 On page 5 of Exhibit B, if you could please take
15 a look at that. Is that your signature down at the
16 bottom?

17 MR. HOJATI: Yes.

18 JUDGE KLETTER: And to the right, there's a date?

19 MR. HOJATI: Yes.

20 JUDGE KLETTER: And what is the date that's
21 written there?

22 MR. HOJATI: It's 2018. 12 -- 12/28/2018.

23 JUDGE KLETTER: So when you signed this
24 document --

25 MR. HOJATI: I didn't look at the dates. So I

1 signed it because I trusted Jay. So if the date is wrong,
2 so then I guess it's wrong, right. Yeah.

3 JUDGE KLETTER: Okay. I don't have any further
4 questions.

5 I'd just like to check with my Panel.

6 Do you have any questions Judge Lam?

7 JUDGE LAM: No questions for now. Thank you.

8 JUDGE KLETTER: And, Judge Lambert, do you have
9 any questions?

10 JUDGE LAMBERT: I have no questions. Thanks.

11 JUDGE KLETTER: So I'd like to turn it over to
12 Franchise Tax Board.

13 I just want to confirm with you, are -- do you --
14 sorry. Are you ready to begin your presentation?

15 MS. BERTANI: Yes, Judge. Thank you.

16 JUDGE KLETTER: Okay. You'll have 75 minutes.
17 Please go ahead.

18 MS. BERTANI: Okay. Thank you.

19

20 PRESENTATION

21 MS. BERTANI: At the heart of this case is
22 Appellants' failure to provide any demonstrable evidence,
23 whatsoever, to substantiate Appellants' claimed tax year
24 2017 flow-through losses over and above the flow-through
25 loss amounts Respondent has already allowed with respect

1 to ICC 1 and the multiple pass-through entities.

2 In fact, in response to Respondent's Protest
3 Determination letter, Appellants expressly conceded to
4 their lack of substantiation documentation as, quote, "The
5 representative agreed the taxpayer has yet to provide the
6 needed substantiation to support his position, but the
7 representative stated that the taxpayer believes he has
8 the documentation," close quote. At that time,
9 Appellants' representative requested the protest to be
10 closed and stated that the taxpayer would appeal and
11 ostensibly provide the needed substantiation documentation
12 at appeal.

13 Respondent respectfully submits that Appellants
14 have proffered no such evidence. The appeal brief cites
15 no such evidence. Appellants analyze no such evidence.
16 And to date, the evidentiary record currently before OTA
17 contains no such evidence. Appellants have not produced
18 one scintilla of demonstrable evidence to rebut or
19 otherwise, overcome Respondent's presumptively correct
20 determinations regarding the claimed flow-through losses
21 at issue.

22 In fact, Appellants just alleged that
23 Mrs. Hojati's Schedule K-1s are purportedly missing from
24 Respondent's flow-through loss determinations, and in the
25 very same statement conceded that Appellants don't have

1 the allegedly missing K-1s for Mrs. Hojati.

2 Mr. Hojati just testified that Mr. Arora had
3 prepared his tax returns for over 30 years and had all of
4 the information regarding Mr. Hojati's basis in the
5 entities at issue. There's not one single document in the
6 record to substantiate or proffer that information.
7 Despite Respondent's expressly request at audit and
8 protest for Appellants to provide their substantiation
9 documentation, Appellants failed to do so, which is why
10 Respondent constructed basis schedules using California
11 K-1 information available to Respondent, via prior tax
12 return filings.

13 Again, here at appeal, Appellants have failed to
14 proffer a single exhibit or corroborated analysis
15 justifying why Appellants are entitled to any flow-through
16 losses tax for tax year 2017 exceeding the amounts that
17 Respondent has already allowed. Respondent respectfully
18 maintains that the barren evidentiary record in this case
19 on its face is insufficient to warrant any additional
20 flow-through losses for tax year 2017.

21 Based on Respondent's adjustments to Appellants'
22 ICC flow-through losses and losses for multiple tax
23 pass-through entities, Respondent revised Appellant's
24 California itemized deductions to the maximum amount
25 allowed for Appellants' filing status. Although

1 Appellants contest the propriety of Respondent's
2 adjustments in this regard, here, again, Appellants'
3 evidentiary record does not bear out Appellants' position
4 in this case.

5 In addition to the claimed flow-through losses
6 and itemized deductions at issue, Appellants also contest
7 Respondent's imposition of a delinquent return penalty
8 ostensibly because Appellants relied on a third party to
9 agent to file their tax year 2017 return in a timely
10 manner. But the fact of the matter is that Appellants'
11 2017 return was filed approximately nine months after the
12 original filing deadline and approximately three months
13 after the extended deadline. The evidentiary record at
14 bar neither infers nor much less proves that Appellants
15 filed their 2017 tax return by the well established due
16 date.

17 When Respondent imposes a delinquent return
18 penalty, the law presumes that the penalty was imposed
19 correctly, and Appellants have failed to overcome
20 Respondent's presumptively correct determination, or
21 otherwise establish reasonable cause to abate the
22 delinquent return penalty. Respondent respectfully
23 maintains that Appellants' evidentiary record here is
24 insufficient to establish error in Respondent's prior
25 determinations in this case.

1 And Respondent now turns to a brief discussion of
2 relevant case law and statutory law applicable to the
3 issues at appeal. The law provides that a shareholder is
4 not permitted to recognize pass-through losses and
5 deductions from an S corporation if those losses and
6 deductions exceed the shareholder's basis in the
7 corporation stock and in the corporation's indebtedness to
8 the shareholder. If pass-through losses exceed the
9 shareholder's basis, then the shareholder can only
10 recognize the losses to the extent of existing basis.

11 And IRC section 1366(d) (2) instructs that the
12 amount by which the losses exceed basis is suspended and
13 carried over to subsequent years until the shareholder
14 substantiates sufficient basis to use the excess loss.
15 Case precedent clarifies that for a shareholder to
16 substantiate basis, whether stock basis or debt basis, the
17 shareholder must make an economic outlay that leaves the
18 shareholder poorer in a material sense. That's because
19 Congress intended to limit a shareholder's ability to
20 deduct corporation losses by the amount the shareholder
21 actually invests in the S corporation.

22 In determining whether a loan is an investment,
23 the Eight Circuit adopted the Tax Court's formulation of
24 the economic outlay doctrine, which states that for basis
25 to increase, a loan from a shareholder to an S corporation

1 must be an actual economic outlay of money by the
2 shareholder. This economic outlay must leave the taxpayer
3 poorer in a material sense. This doctrine ensures that
4 the transaction has some substance or utility beyond the
5 creation of a tax deduction. The shareholder's own funds
6 must be at risk. Only where a shareholder provides his
7 own money or money he is directly liable for to the S
8 corporation will basis increase. Put simply, the
9 corporation must actually be indebted to the shareholder
10 for the shareholder's own money.

11 So with this precedent in mind, Respondent now
12 turns to the facts in evidence in this case and maintains
13 that Appellants have failed to proffer or even discuss any
14 demonstrative evidence to substantiate that Appellants
15 invested actual economic outlays in ICC 1 and the multiple
16 pass-through entities to justify increasing Appellants'
17 corresponding tax year 2017 flow-through losses over and
18 above the amounts Appellants has already allowed. On
19 December 26, 2018, ICC filed -- ICC 1 filed a 2017 tax
20 return claiming approximately \$2.2 million ordinary
21 business income loss with flow-through losses allocated to
22 shareholder Hamid Hojati as reported on the attached
23 Schedule K-1.

24 On January 14th, 2019, Appellants filed a 2017
25 tax return claiming, among other things, approximately

1 \$4.4 million losses from multiple pass-through entities.
2 At audit and protest, Respondent expressly requested that
3 Appellants provide documentation to substantiate the
4 claimed shareholder flow-through losses. And in both
5 instances, Appellants failed to do so. With respect to
6 the claimed ICC 1 flow-through loss, Appellants produced a
7 shareholder basis schedule using federal amounts and to
8 substantiate the claimed flow-through losses from multiple
9 pass-through entities, Appellants produced only federal
10 Schedule K-1s.

11 As a result, Respondent used information at its
12 disposal comprising California Schedule K-1s from prior
13 tax filings to reconstruct Appellants' ICC 1 basis
14 schedule and a schedule of flow-through losses for
15 multiple pass-through entities, which demonstrated that
16 Appellants overstated their ICC 1 shareholder basis by
17 approximately \$865,000. And Appellants overstated their
18 flow-through losses for multiple pass-through entities by
19 approximately \$185,000.

20 Respondent respectfully maintains that Appellants
21 have failed to proffer a single exhibit or any other
22 demonstrative evidence to overcome Respondent's
23 determinations. The evidentiary record currently at bar
24 is devoid of any demonstrable evidence to substantiate
25 that Appellants made additional capital contributions,

1 basis adjustments, loans, or any other recognizable
2 investments or economic outlays to commensurate with
3 allowing any additional flow-through losses for tax year
4 2017.

5 Respondent now addresses its adjustments to
6 Appellants' claimed 2017 itemized deductions, which are
7 based on Respondent's flow-through loss determinations.
8 More, specifically, Appellants reported approximately
9 \$52,000 in itemized deductions on their 2017 tax return.
10 At audit, Respondent determined that the amount of
11 allowable itemized deductions is \$14,300 based on
12 Appellants filing status resulting in a difference of
13 approximately \$37,000, which Respondent added back to
14 Appellants' revised taxable income, along with Appellants'
15 overstated flow-through loss amounts. Contrary to
16 Appellants' arguments contesting Respondent's adjustments,
17 as Respondent has previously stated and as case law
18 confirms, Respondent's determinations are presumptively
19 correct, and Appellants have neither proffered nor
20 analyzed any demonstrable evidence at audit protest or
21 here on appeal to overcome Respondent's determinations.

22 Respondent now turns to the final issue, the
23 delinquent return penalty at issue in this case.
24 Appellants tax year 2017 return was filed approximately
25 nine months after the original filing deadline and three

1 months after the extended deadline, as I previously
2 stated. Contrary to Appellants' arguments for abating the
3 delinquent return penalty, the evidentiary record here
4 does not bear out or in any way substantiate Appellants'
5 uncorroborated reasonable cause claim, and Respondent
6 respectfully maintains that its presumptively correct
7 imposition of the delinquent return penalty should be
8 sustained.

9 In order to justify abatement of the delinquent
10 return penalty, Appellants bear the burden of proving that
11 the untimely filing of their tax return was due to
12 reasonable cause and not willful neglect, and Respondent
13 respectfully maintains that Appellants have not met that
14 burden. None of Appellants' arguments or the information
15 presented by Appellants establish that their failure to
16 timely file was due to reasonable cause. Here, Appellants
17 argue that they followed an established procedure. They
18 reviewed and authorized the returns that their preparer
19 had filed for them for over 30 years and was told that the
20 return was filed timely.

21 However, the law is clear. Each taxpayer has a
22 personable -- a personal nondelegable obligation to ensure
23 the timely filing of their returns, and reliance on an
24 agent to perform this act does not constitute reasonable
25 cause to abate a late-filing penalty. Moreover, the

1 exercise of ordinary business care and prudence requires
2 that Appellants do more than merely perform or delegate
3 the tasks necessary to timely file their return. It also
4 requires Appellants to personally verify that the return
5 had been successfully and timely filed and to take the
6 appropriate corrective action upon discovering that the
7 return was not filed in a timely manner.

8 The record currently before OTA does not show
9 that Appellants took any such actions but, instead, chose
10 to rely solely on Mr. Arora. Therefore, on the facts and
11 evidence in the record, Appellants have neither
12 established that the 2017 return was filed timely, nor met
13 their burden of establishing reasonable cause to justify
14 penalty abatement. In conclusion, Respondent respectfully
15 submits that the evidentiary record currently at bar is
16 insufficient to substantiate and allow Appellants any
17 additional flow-through losses from ICC 1 and the multiple
18 pass-through entities for tax year 2017.

19 In addition, Respondent maintains its itemized
20 deductions, determination, and imposition of the
21 delinquent return penalty, Respondent respectfully request
22 that OTA sustain its determinations in their entirety.

23 That concludes my presentation, and I'm happy to
24 answer your questions.

25 Thank you.

1 JUDGE KLETTER: This is Judge Kletter. Thank
2 you, Ms. Bertani, for your presentation.

3 I'm going to just check with my Panel.

4 Judge Lambert, so you have any questions for
5 either party?

6 JUDGE LAMBERT: I have no questions. Thanks.

7 JUDGE KLETTER: And, Judge Lam, do you have any
8 questions for either party?

9 JUDGE LAM: No other questions. Thank you.

10 JUDGE KLETTER: Okay. Mr. Mather, you'll be
11 allowed five minutes to make a final statement, a rebuttal
12 to Ms. Bertani -- what Ms. Bertani said, or if there's
13 anything else you would like to say before the case is
14 submitted. You'll have five minutes. Are you ready to
15 begin?

16 MR. MATHER: Yes.

17 JUDGE KLETTER: Please go ahead.

18 MR. MATHER: Thank you.

19

20 CLOSING STATEMENT

21 MR. MATHER: So according to the Franchise Tax
22 Board, unless they have a piece of paper, there's no way
23 to overcome the presumption of the Franchise Tax Board's
24 determination. That simply isn't the law. We have an
25 explanation here. Well, let's start with what we have

1 from the Franchise Tax Board on the basis computation. We
2 have a basis computation that treats the entire initial
3 capitalization of ICC 1 is \$5,000. A functioning
4 multimillion dollar body shop capitalized with \$5,000. Of
5 course, that's ridiculously absurd.

6 Second, we have the explanation of Mr. Hojati
7 that the million-and-a-half dollars for which he was
8 personally liable on the paint -- the new paint contract
9 was contributed to the corporation. And we see it in the
10 balance sheet that is a document in the evidence. So we
11 know what happened. We know the million-and-a-half went
12 in. We have Mr. Hojati's testimony that he was personally
13 liable for it. It fits the description of the economic
14 outlay that -- that the Franchise Tax Board suggest is the
15 applicable standard. It doesn't have to be a loan, per
16 se, from the shareholder to the corporation. It could be
17 a debt the shareholder incurs with the proceeds going to
18 the corporation. That is exactly what happened in this
19 case.

20 So we have an explanation of how the basis is,
21 covered on either of two means; the additional
22 contribution of the operating assets of the business,
23 which is not accounted for by the FTB, or the
24 million-and-a-half dollar personal liability the proceeds
25 of which went into the corporation to fund the

1 corporation's obligations, and the payments that I
2 mentioned in my statement.

3 Now, with respect to the second issue, the
4 reconciliation, again, this is -- this is a product of the
5 FTB not retaining the entire tax return. So they tried to
6 reconstruct the tax return looking only at Mr. Hojati's
7 K-1s, not at Mrs. Hojati's K-1s, and coming up a little
8 bit short. We know Mrs. Hojati had K-1s because Mr. Arora
9 prepared the flow-through tax returns. And on the 540
10 itself, Exhibit B, page 20, he lists Mrs. Hojati's K-1s,
11 or at least an amount for Mrs. Hojati, separate and apart
12 from Mr. Hojati. So when the FTB reconstructs using Mr.
13 Hojati's K-1s, of course, Mrs. Hojati's are missing. So
14 -- and we know that, so -- from the documents that are in
15 the record. As I mentioned before, I think the -- the
16 itemized deductions is a -- is a computational adjustment.

17 And with respect to the -- with respect to the
18 late late-filing penalty, it was -- the FTB admits that it
19 was three -- less than three months late for -- on the
20 540, apparently, and yet, has computed a 25 percent
21 penalty. And the reasonable cause is established in the
22 cases that we cited in our brief, which is it is
23 recognized reasonable cause when you have a longstanding
24 practice that has worked flawlessly for years. You get
25 one hiccup, it's not -- it can be reasonable cause.

1 Mr. Hojati doesn't need to prepare the return
2 himself, take it and mail it for it to be reasonable
3 cause. Short of that, he did everything that was
4 reasonable ordinary business care and prudence relying on
5 a 30-year experience where there was no delinquent
6 filings.

7 And that concludes our remarks.

8 JUDGE KLETTER: This is Judge Kletter. Thank
9 you, Mr. Mather. I did have one question before I
10 concluded the hearing. With respect to the, I guess,
11 rebates or prebates, you know, large multiyear contracts,
12 I don't see that there are any in the record. And I'm
13 just wondering, like, were those written contracts or oral
14 contracts or --

15 MR. MATHER: The one that matters is the one that
16 started in 2017, and we -- we weren't able to locate it.

17 JUDGE KLETTER: Okay. Thank you.

18 So with that said, this concludes this hearing.

19 This Panel will meet and decide the case based on
20 the documents and the testimony that was presented. We
21 will issue our written decision no later than 100 days
22 from today. The case is submitted, and the record is now
23 closed. This concludes this hearing session.

24 Thank you everyone.

25 (Proceedings adjourned at 4:23 p.m.)

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

I have hereunto subscribed my name this 30th day of October, 2024.

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