

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:

J. LEE

) OTA Case No.: 220410186
)
)
)
)
)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant:

James R. Murphy, Representative

For Respondent:

Jason Riley, Attorney

J. LAMBERT, Administrative Law Judge: On March 14, 2025, the Office of Tax Appeals (OTA) issued an Opinion in this appeal that sustained respondent Franchise Tax Board’s (FTB’s) action denying J. Lee’s (appellant’s) claim for refund of \$38,095 for the 2016 tax year. Specifically, the Opinion held that appellant has not shown entitlement to a claimed pass-through California research credit.

Appellant timely filed a petition for rehearing. OTA will grant a rehearing where one of the following grounds exists and materially affects the substantial rights of the party (here, appellant) seeking a rehearing: (1) an irregularity in the appeal proceedings which occurred prior to issuance of the Opinion and prevented fair consideration of the appeal; (2) an accident or surprise, occurring during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered evidence, material to the appeal, which the party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law in the OTA appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6).)

Appellant argues that the Opinion improperly placed the burden on appellant to establish entitlement to the research credit, and that FTB did not use the proper forum to determine whether appellant is entitled to the research credit. It appears that appellant is arguing that there is insufficient evidence to justify the Opinion, that the Opinion is contrary to law, and that there was an error in the appeal proceedings. To find that there is insufficient evidence to justify the Opinion, OTA must find, after weighing the evidence in the record, including reasonable

inferences from that evidence, that OTA clearly should have reached a different opinion. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P.) To find that the Opinion is contrary to law, OTA must determine whether the Opinion is unsupported by any substantial evidence. (*Ibid.*) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Ibid.*) A procedural “error in law” means an error in the OTA appeals hearing or proceeding, other than a legal error in the Opinion. (Cal. Code Regs., tit. 18, § 30604(b).)

As background, appellant, a California resident, was a shareholder in Pioneer Circuits, Inc. (Pioneer Circuits), an S corporation. Pioneer Circuits filed an original 2016 California S Corporation Franchise or Income Tax Return (Form 100S) that did not report or claim a California research credit. Similarly, appellant filed an original 2016 California Resident Income Tax Return that did not report a pass-through California research credit from Pioneer Circuits. However, appellant subsequently filed a 2016 California Amended Individual Income Tax Return (Form 540X) that claimed a pass-through California research credit from Pioneer Circuits, even though Pioneer Circuits never reported or claimed such credit on its originally filed 2016 Form 100S and there was no reliable evidence in the record indicating it sent FTB an amended 2016 Form 100S doing the same. FTB treated appellant’s Form 540X as a claim for refund, which it denied because it was barred by the statute of limitations. On appeal, FTB conceded that appellant’s claim for refund was not barred by the statute of limitations, but FTB raised a new argument that appellant did not provide evidence substantiating entitlement to the claimed research credit.

In its Opinion, OTA held that FTB raised a new matter during the appeal and, therefore, the burden on the new matter was on FTB, citing California Code of Regulations, title 18, (Regulation) section 30219(a) and *Appeal of Mendelsohn* (85-SBE-141) 1985 WL 15923. The Opinion then held that FTB met its initial burden because the evidence in the record indicated that Pioneer Circuits never claimed a California research credit. As a result, the Opinion determined that appellant had the burden to establish entitlement to the California research credit. The Opinion held that appellant did not meet his burden because he only provided

Form 540X and an unsigned, pro forma Form 100S from Pioneer Circuits reporting a research credit.¹

Appellant argues that the Opinion placed the burden solely on appellant. However, the Opinion held that FTB had the initial burden of proof because it raised a new matter on appeal, that FTB met its initial burden, and that the burden shifted to appellant to establish entitlement to the California research credit. Therefore, the Opinion did not place the burden solely on appellant, and appellant has not shown the Opinion was contrary to law. In addition, appellant provided no evidence to establish entitlement to the credit. As noted in the Opinion, placing the initial burden of proof on FTB does not relieve appellant of the burden to establish entitlement to the claimed credit. The burden shifted to appellant, and appellant did not provide evidence to establish entitlement to the research credit. Therefore, appellant has not shown there was insufficient evidence to justify the Opinion.

Lastly, appellant argues that FTB did not use the proper forum to determine whether appellant is entitled to the research credit. Specifically, appellant asserts that FTB's introduction of the issue of entitlement to the research credit during the appeals process circumvents the collection of evidence and investigatory process that can be used by FTB prior to the appeal before OTA.² However, OTA has jurisdiction over this appeal pursuant to Revenue and Taxation Code section 19324, so this is not the improper forum. In addition, raising a new matter on appeal simply places the initial burden to FTB, pursuant to Regulation section 30219(a) and *Appeal of Mendelsohn, supra*, but does not mean that OTA is the improper forum. Furthermore, OTA requested additional briefing and provided appellant the opportunity to submit evidence to demonstrate entitlement to the credit, but appellant did not provide evidence sufficient to establish entitlement to the credit. Therefore, appellant has not shown there was an error in law in the appeal proceedings.

¹ OTA stated that generally a taxpayer claiming a research credit under Internal Revenue Code section 41, as modified by Revenue and Taxation Code section 23690, must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit, citing Treasury Regulation section 1.41-4(d), *Appeal of Pino*, 2020-OTA-375P, and Regulation section 19032(a)(5).

² The Opinion noted that because Pioneer Circuits did not claim the California research credit, there would have been no opportunity or reason for FTB to audit or examine Pioneer Circuits' 2016 Form 100S for the purpose of verifying the California research credit at the S corporation level.

Appellant has not established that any ground exists to warrant a rehearing. Therefore, appellant's petition for rehearing is denied.

Signed by:

Josh Lambert

CB1E7DA37831416

Josh Lambert
Administrative Law Judge

We concur:

DocuSigned by:

Erica Parker

6651E0AAC34B4E6

Erica Parker
Hearing Officer

DocuSigned by:

Kenneth Gast

3AE5C32BB93B456

Kenneth Gast
Administrative Law Judge

Date Issued: 8/28/2025