

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)
J. LEE) OTA Case No. 220410186
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OPINION

Representing the Parties:

For Appellant: James R. Murphy, Representative

For Respondent: Jason Riley, Attorney

For Office of Tax Appeals: William J. Stafford, Attorney

E. LAM, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 19324, J. Lee (appellant) appeals an action by respondent Franchise Tax Board (FTB) denying appellant’s claim for refund of \$38,095 for the 2016 tax year.

Appellant waived the right to an oral hearing; therefore, the matter was submitted to the Office of Tax Appeals (OTA) on the written record pursuant to California Code of Regulations, title 18, section 30209(a).

ISSUE

Whether appellant has shown entitlement to a claimed pass-through California research credit in an amended personal income tax return.

FACTUAL FINDINGS

1. During the 2016 tax year appellant was a shareholder in Pioneer Circuits, Inc. (Pioneer Circuits), a California S corporation.
2. On August 17, 2017, Pioneer Circuits timely filed a 2016 California S Corporation Franchise or Income Tax Return (Form 100S). Pioneer Circuits’ 2016 Form 100S did not claim a California research credit.
3. On October 13, 2017, appellant timely filed his 2016 California Resident Income Tax Return (Form 540). Appellant’s 2016 Form 540 did not report a pass-through California research credit from Pioneer Circuits.

4. FTB received appellant's 2016 California Amended Individual Income Tax Return (Form 540X), which claimed a pass-through California research credit of \$47,863 from Pioneer Circuits.

5. Appellant's 2016 Form 540X requested a refund of \$38,095 and stated that:

TAXPAYER IS AMENDING THEIR [sic] 2016 TAX RETURN IN ORDER
TO INCLUDE A RESEARCH AND DEVELOPMENT [sic] CREDIT FROM
PIONEER CIRCUITS, INC.

Along with Form 540X, appellant also included a 2016 California Form 3523 (Research Credit Form) that set forth a pass-through California research credit of \$47,863 for appellant¹ and referenced that the pass-through California research credit originated from Pioneer Circuits. Collectively, these documents total 38 pages in length.

6. On January 18, 2022, FTB sent appellant a letter denying appellant's claim for a refund for the 2016 tax year because FTB determined that appellant had not filed his Form 540X before the expiration of the statute of limitations for claiming a refund.

7. Appellant timely filed this appeal.

8. During the appeal proceedings with OTA, appellant provides a copy of an unsigned pro forma 2016 Amended Corporation Franchise or Income Tax Return (Form 100X) for Pioneer Circuits, which lists a California research credit generated for the 2016 tax year. Attached as part of the unsigned pro forma Form 100X are the following two documents: (i) a pro forma 2016 Schedule K-1 for appellant, which sets forth a research credit from Pioneer Circuits, and (ii) a pro forma 2016 Research Credit Form, which includes the California corporation number of Pioneer Circuits and lists a California research credit of \$208,106 generated by Pioneer Circuits for the 2016 tax year (collectively, pro forma attachments). These documents total 43 pages in length.

9. Additionally, appellant provides an affidavit from a partner at the accounting firm that prepared the tax return documents discussed above for both appellant and Pioneer Circuits, and who individually prepared appellant's Form 540X. The affiant states therein that the "support department" of the accounting firm prepared an envelope containing appellant's Form 540X and the pro forma Form 100X for Pioneer Circuits for the 2016 tax year, and on or around October 13, 2021, sent both to FTB via certified mail, return receipt requested.

¹ The Research Credit Form that was attached to appellant's Form 540X lists the social security number of appellant (not the California corporation number of Pioneer Circuits).

10. Appellant provides a U.S. Postal Service (USPS) tracking number (Proof of Mailing), which indicates that a letter or package was mailed via USPS on October 12, 2021, which was one day prior to the expiration of the four-year statute of limitations. A copy of the Certified Mail Receipt from USPS sets forth the following itemized fees: (i) a postage fee of \$2.36, (ii) a certified mail fee of \$3.75, and (iii) a return receipt fee of \$3.05. FTB provides tracking information based on the Proof of Mailing, showing it was mailed on October 12, 2021, and received by FTB on October 16, 2021.
11. After reviewing the Proof of Mailing, FTB concedes that appellant filed his Form 540X in a timely manner. However, FTB raises a new argument that appellant has not produced any evidence related to qualified research expenses of Pioneer Circuits, and has therefore not substantiated any alleged pass-through California research credit. FTB also argues that appellant failed to indicate on the Form 540X that the pass-through California research credit from Pioneer Circuits was reported inconsistently with Pioneer Circuits' Form 100S, which did not include such credit for the 2016 tax year.
12. In a letter dated November 6, 2023, OTA requested additional briefing and offered appellant an opportunity to submit an additional brief and/or evidence to demonstrate that Pioneer Circuits qualified for research credits under Internal Revenue Code (IRC) section 41(d)(1) for the 2016 tax year, which would subsequently be passed on to appellant.

DISCUSSION

I. Burden of Proof

a. Generally

Tax credits are a matter of legislative grace, and taxpayers bear the burden of proving they are entitled to claimed tax credits. (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-046P.) Statutes granting tax credits are to be construed strictly against the taxpayers with any doubts resolved in FTB's favor. (*Ibid.*) The taxpayer has the burden of showing that the requirements for the research credit are satisfied. (*Ibid.*) Unsupported assertions are not sufficient to satisfy the taxpayers' burden of proof. (*Appeal of Morosky*, 2019-OTA-312P.) In the absence of credible, competent, and relevant evidence showing error in FTB's determination, FTB's determination must be upheld. (*Ibid.*)

b. New Matter on Appeal

California Code of Regulations, title 18, section 30219(a), provides that the burden of proof is on the appellant as to all issues of fact, except that, in respect of any new matter first raised by FTB during an appeal before OTA, the burden with respect to the new matter shall be on FTB. (Cal. Code Regs., tit. 18, § 30219(a).)

In *Appeal of Mendelsohn*, the California State Board of Equalization (BOE) expressly adopted the U.S. Tax Court's "new matter" rule, as formulated in *Achiro v. Commissioner* (1981) 77 T.C. 881 (*Achiro*). (*Appeal of Mendelsohn* (85-SBE-141) 1985 WL 15923 (*Mendelsohn*).) Citing *Achiro*, *Mendelsohn* provides, "[i]f [the taxing agency's] position on appeal either alters the original deficiency or requires the presentation of different evidence, then a new matter has been introduced and the burden of proving that new position shifts to [the taxing agency]." (*Achiro*, *supra*, 77 T.C. at p. 890; see also *Dagres v. Commissioner* (2011) 136 T.C. 263, 277-279 [to same effect]; cf. *Appeal of Sierra Pacific Industries* (94-SBE-002) 1994 WL 14076 ["If respondent's position on appeal results in a larger deficiency . . . or requires the presentation of different evidence, then a new matter has been introduced and the burden of proving that new position shifts to respondent"].) Under the new matter rule, "a new position taken . . . is not necessarily a 'new matter,' especially when it merely clarifies or develops the original determination without being inconsistent or increasing the amount of deficiency." (*Estate of Jayne, et al. v. Commissioner* (1974) 61 T.C. 744, 748, citing *McSpadden v. Commissioner* (1968) 50 T.C. 478, 492-493.) Therefore, when FTB has raised a new theory in its brief on appeal that does not simply clarify or develop its original position, it is FTB's burden to present new evidence to support its position on appeal. (*Appeal of Mendelsohn, supra*.)

II. Law and Analysis

a. New Matter on Appeal

FTB originally denied appellant's claim for refund for the 2016 tax year based on its determination that appellant had not filed the Form 540X before the statute of limitations expired under R&TC section 19306.² On appeal, FTB conceded that appellant timely filed the claim for refund for the 2016 tax year. However, FTB raised new arguments on appeal, asserting that appellant's claim for refund should be denied because appellant failed to substantiate the

² Under R&TC section 19306, the last day to file a claim for refund is the later of: (1) four years from the date the return is filed, if filed within the extended due date; (2) four years from the due date of the return, without regard to extensions; or (3) one year from the date of the overpayment. (R&TC, § 19306.)

claimed pass-through research credit and, furthermore, that appellant failed to file with FTB a statement identifying inconsistency with Pioneer Circuits' 2016 Form 100S as required by IRC section 6037(c)(2), as modified by R&TC section 18601(e)(2)(A). These new arguments are based on a different factual basis and rationale than FTB's original position that focused on the statute of limitations under R&TC section 19306. Because FTB introduced a new theory on appeal that does not merely clarify or develop its original position, FTB bears the burden of presenting new evidence to support its new argument. (See *Appeal of Mendelsohn, supra.*)

b. California Research Credit

Generally, a taxpayer claiming a research credit under IRC section 41, as modified by R&TC section 23690 must retain records in sufficiently usable form and detail to substantiate that the expenditures claimed are eligible for the credit. (Treas. Reg. 1.41-4(d); *Appeal of Pino*, 2020-OTA-375P; see Cal. Code Regs., tit. 18, § 19032(a)(5).) To be eligible for a research credit under IRC section 41(a)(1), as modified by R&TC section 23609, taxpayers must prove that they performed qualified research, or paid someone else to perform qualified research, during the year at issue. Qualified research is research that satisfies four tests:³

1. Section 174 Test: expenditures connected with the research must be eligible for treatment as expenses under IRC section 174 (IRC, § 41(d)(1)(A));
2. Technological in Nature Test: research must be undertaken for the purpose of discovering technological information (IRC, § 41(d)(1)(B)(i));
3. Business Component Test: the taxpayer must intend that the information to be discovered be useful in the development of a new or improved business component (e.g. product) of the taxpayer (IRC, § 41(d)(1)(B)(ii)); and
4. Process of Experimentation Test: substantially all of the research activities must constitute elements of a process of experimentation for a purpose relating to a new or improved function, performance, reliability, or quality. (IRC, § 41(d)(1)(C), 41(d)(3).)

FTB asserts that appellant has failed to provide sufficient evidence to substantiate that Pioneer Circuits either engaged in qualifying research activities or claimed a research credit for the 2016 tax year. Therefore, without such substantiation at the S corporation level, appellant also did not establish that any California research credit was available to be claimed on his individual tax return.

³ For purposes of the California research credit, "qualified research" only includes research conducted in California. (R&TC, § 23609(c)(2)(A).)

In response, appellant contends on appeal that he is not required to substantiate the underlying California research credit by Pioneer Circuits under IRC section 41, as modified by R&TC section 23690, in order to determine whether the research credit passes through to his individual return. Appellant argues that FTB did not conduct an audit or otherwise examine Pioneer Circuits' tax returns under R&TC section 19032 to verify whether the research credit was properly claimed; therefore, FTB cannot require appellant to substantiate the research credit for Pioneer Circuit.⁴ Appellant further asserts that because FTB raises the issue of substantiation for the first time on appeal, the burden of substantiating Pioneer Circuits' research credit, which by extension, the California research credit claimed by appellant, rests with FTB, rather than with appellant.

However, while it is true that FTB bears the burden of proof when raising a new argument on appeal, this does not relieve appellant of the obligation to establish entitlement to the California research credit on this appeal. Here, FTB has met its initial burden as evidence in the record indicates that Pioneer Circuits did not claim a California research credit on its original return or timely amended its return to do so. Accordingly, the evidentiary burden to support the claimed credit is properly on appellant. During the appeal proceedings, OTA requested further briefing and offered appellant an opportunity to submit additional evidence to demonstrate that Pioneer Circuits qualified for research credits under IRC section 41(d)(1) for the 2016 tax year, which would subsequently then be passed-through to the appellant. Here, appellant has produced no substantiating evidence relating to whether Pioneer Circuits engaged in qualified research activity during the 2016 taxable year.⁵ Appellant relies solely upon Form 100X information allegedly submitted to FTB with Form 540X. However, merely signing a tax return under penalty of perjury does not establish the facts contained therein, and certainly amounts listed on a pro forma, unsigned return remitted by an individual that is not the entity that would have filed the return, are not alone sufficient to satisfy appellant's burden to substantiate the

⁴ There is no evidence in the record indicating that Pioneer Circuits claimed the California research credit, either on its original Form 100S return or a Form 100X amended return, either timely or untimely (Forms 100S and 100X provided by appellant on appeal are unsigned and were apparently never submitted to FTB by Pioneer Circuits itself). Therefore, it appears that there would have been no opportunity or reason for FTB to audit or examine Pioneer Circuits' 2016 tax return for the purpose of verifying the California research credit at the S corporation level.

⁵ Appellant argues in the additional brief responsive to the additional briefing request that, among other things, it is unfair and prejudicial to require an individual taxpayer to "marshal legal theories and factual basis on its tax return" for each element of the tax credits. However, this evidentiary requirement is not one imposed upon a tax filer upon filing their return, it is instead a basic evidentiary requirement of a taxpayer seeking a claim for refund. (Cal. Code Regs., tit. 18, § 19322(a) ["The claim must set forth in detail each ground upon which a refund or credit is claimed and facts sufficient to apprise [FTB] of the exact basis thereof"].)

credits claimed on appellant’s claim for refund. (See *Roberts v. Commissioner* (1974) 62 T.C. 834, 837; Cal. Code Regs., tit. 18, § 19322.) Accordingly, FTB’s denial of appellant’s claim for refund for the 2016 tax year must be sustained on that basis alone.⁶

HOLDING

Appellant has not shown entitlement to a claimed pass-through California research credit in an amended personal income tax return.

DISPOSITION

FTB’s action denying appellant’s claim for refund is sustained.

DocuSigned by:
Eddy Y. H. Lam
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Eddy Y.H. Lam
Administrative Law Judge

We concur:

DocuSigned by:
John O Johnson
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John O. Johnson
Administrative Law Judge

DocuSigned by:
Keith T. Long
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Keith T. Long
Administrative Law Judge

Date Issued: 3/14/2025

⁶ Appellant’s failure to substantiate the California research credit effectively determines the outcome of this appeal. To the extent either party raises other arguments that this Opinion does not specifically address, including the question of determining whether appellant’s October 12, 2021 submission to FTB contained the 100X documentation in addition to the 540X documentation, this panel has reviewed those arguments and considers them not pertinent to the disposition of this appeal. Therefore, OTA will not address the additional contention raised by the parties with regard to appellant’s satisfaction with filing the statement identifying an inconsistency under IRC section 6037(c)(2)(A)(ii) and R&TC section 8601(e)(2)(A)(ii).