

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
ADVANCED AMERICAN LABORATORIES, INC.,) OTA NO. 240917392
)
)
APPELLANT.)
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TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, March 12, 2026

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings,
taken in the State of California, commencing
at 2:43 p.m. and concluding at 4:02 p.m. on
Thursday, March 12, 2026, 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 VERONICA I. LONG
ALJ HANS FAMULARO

For the Appellant: P. MICHAELS
FRANK SEKULA

For the Respondent: STATE OF CALIFORNIA
FRANCHISE TAX BOARD

SOPHIE KUEHL
NATHAN HALL

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-2 were received into evidence at page 7.)

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

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California; Thursday, March 12, 2026

2:43 p.m.

JUDGE KLETTER: Now we can go on the record.

I'm Judge Kletter. With me are panel members
Veronica Long and Hans Famularo. This is the appeal of
Advanced American Laboratories. It's OTA
Case No. 240197392. Today is Thursday, March 12th, 2026,
and the time is 2:43 p.m.

Also present -- sorry. Yes. Also present is our
hearing reporter, Ms. Alonzo who is reporting this hearing
verbatim. To ensure that we have an accurate record, we
ask everybody speaks one at the same time and does not
speak over each other. Please speak clearly and loudly.
When needed, Ms. Alonzo will stop the hearing process and
ask for clarification. After the hearing, Ms. Alonzo will
produce the official hearing transcript, which will be
available on the Office of Tax Appeals website. The
hearing transcript and the video recording are part of the
public record. This proceeding is a live broadcast, and
any information shared your screen is publicly viewable.

And as a reminder, the Office of Tax Appeals is
not a court. We are an independent appeals body. The
Office of Tax Appeals is staffed by tax experts and is
independent of the state's tax agencies.

1 I ask that you please direct your arguments to
2 the panel, and please be respectful of one another during
3 this hearing. And if there are any questions during this
4 process, please feel free to stop me and direct any
5 questions to me.

6 Now, I would like the parties to please identify
7 themselves for the record and just state your name, and
8 let's begin with Appellant.

9 MR. MICHAELS: Patrick Michael's, CEO of Advanced
10 American Laboratories, the Appellant in this case.

11 MS. KUEHL: Good afternoon. I'm Sophie Kuehl,
12 representation for the Franchise Tax Board.

13 MR. HALL: And Nathan Hall on behalf of
14 Respondent Franchise Tax Board.

15 JUDGE KLETTER: And, Mr. Sekula, could you please
16 just state your name.

17 MR. SEKULA: Yes. Yes. I'm Frank Sekula. If
18 work for Business Incentive Solutions, and we had helped
19 Mr. Michaels with his tax returns, which includes the
20 research tax credit.

21 JUDGE KLETTER: Great. So, the issue we have for
22 today is whether Appellant has demonstrated that it
23 engaged in qualified research under California Revenue &
24 Taxation Code 23609, and if so, whether Appellant has
25 substantiated its qualified research expenses.

1 With respect to the evidentiary record, Franchise
2 Tax Board has provided Exhibits A, as an apple, through H,
3 as in Henry. Appellant did not object to those exhibits.
4 Therefore, those exhibits are entered into the record.

5 (Department's Exhibits A-H were received into
6 evidence by the Administrative Law Judge.)

7 JUDGE KLETTER: And Appellant has provided
8 Exhibits 1 through 3. Franchise Tax Board did not object
9 to the admissibility of Exhibits 1 and 2 and, therefore,
10 those are entered into the record.

11 (Appellant's Exhibits 1-2 were received into
12 evidence by the Administrative Law Judge.)

13 JUDGE KLETTER: Now, Mr. Sekula, with respect to
14 the Exhibit 3, can I ask you what the purpose of
15 submitting the IRS check?

16 MR. SEKULA: Just to verify the statement. One
17 of the complaints we have is that, of our 40 clients that
18 have submitted tax help -- that we helped submit tax
19 returns, virtually, all of them have received their
20 refunds from the IRS based on the exact same information
21 that we've sent to the FTB. The reason -- I know that our
22 other clients have received money from the IRS is because
23 we charge them for the service, and they don't pay us
24 unless they receive money from the IRS. So, I wanted
25 to -- to show that this is one of the checks that verify

1 my statement that it's a -- a major oddity that the IRS
2 based on a certain amount -- based on the very specific
3 thorough information that Mr. Patrick's given, was
4 accepted by the IRS. Whereas, the FTB rejects virtually
5 every -- every comment in the -- in his information. That
6 seems very on point.

7 JUDGE KLETTER: Thank you for that explanation.
8 I think that there's no dispute that the IRS accepted the
9 research and development credit. So, I think based on
10 what I've heard, we're going to go ahead and just have
11 Exhibits 1 and 2 in the record, because it was not timely
12 submitted and, you know, there was a deadline. And we did
13 discuss this at the prehearing conference. I think
14 ultimately, I appreciate what you've said, and we will
15 take that into the account but not the exhibit. So --

16 MR. SEKULA: That's fine. You don't need the
17 exhibit if you understand the concept.

18 JUDGE KLETTER: So -- thank you. So, for today,
19 we have approximately 60 minutes. There will be
20 30 minutes for Appellant's presentation, and that includes
21 the testimony of Mr. Michaels. And I will go ahead and
22 swear him in before, Mr. Sekula, you begin your
23 presentation. Then we will have 20 minutes for Franchise
24 Tax Board's presentation, and then we'll have five minutes
25 for Mr. Sekula to provide any closing statement and

1 rebuttal. At various points during the hearing, we may
2 ask questions, and Franchise Tax Board may ask questions
3 of the witnesses following their testimony; and I will
4 confirm with them.

5 So, Mr. Michaels, if I could have you raise your
6 right hand, and ask you.

7

8 P. MICHAELS,

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

12

13 JUDGE KLETTER: Great. Thank you.

14 Mr. Sekula, I will hand it over to you. You will
15 have 30 minutes, and please begin when you are ready.

16 MR. SEKULA: Thank you. I won't need 30 minutes.

17

18 PRESENTATION

19 MR. SEKULA: In this meeting, I believe that the
20 OTA as -- as an objective source, will agree that the
21 American Advanced Lab provided valid research credit --
22 tax credit information. I think you will find when
23 Mr. Michaels goes over the projects, as well as the
24 four-part test, that he submitted very complete, very
25 thorough, very comprehensive information that's quite easy

1 to understand.

2 Clearly, there could be questions on what he
3 submitted, but the FTB generally takes the approach that
4 they accept nothing from any client ever; not one out of
5 100 tax returns that we've been submitting. The FTB is
6 simply not accepting one argument from one client. And
7 that's just does not seem reasonable. Therefore, I want
8 to also go through the opening arguments, which are list
9 of nine complaints. The FTB started most of the exams in
10 late 2024. But for Mr. Michaels' company, Advanced
11 American Labs, they did start his a little earlier. They
12 did start his in August of '23. But we're finding that
13 the vast majority of the 40 clients that we have got their
14 notices in 2024.

15 So, you could see the timeline here is really
16 tough. You got a situation where they're asking a lot,
17 sending as much as 14 IDRs. I'll correct though, for
18 this -- for Mr. Michaels, they only sent 7. But in any
19 event, when you're talking about this kind of a time frame
20 to ask for a lot of more detailed information, it's simply
21 not practical. And this is what their tact is to ask for
22 more and more and more information. Number one, they
23 don't ask any real questions on the information that was
24 submitted.

25 It's important to note that we submitted all this

1 information with the original tax return. It wasn't after
2 the fact. The brief that the FTB mentioned, they said
3 this was submitted after the fact. That's not correct.
4 This is all submitted with the return. We wouldn't submit
5 a return with -- without the back up. That's what we were
6 paid for to do.

7 So anyway let's go to number two. Number two
8 says that this extensive documentation requirements is not
9 proportional to Mr. Michaels' request for \$10,000 in 2019
10 and \$11,000 in 2020. We spent, between my time and his
11 time, a huge proportion of that responding to their
12 countless requests for -- for a fairly marginal --
13 marginal credit. And we spent a lot of time and effort
14 putting that credit together.

15 Let's go to number three. Well, we've already
16 talked about number three. Number three talks about
17 denying everything. They denied -- out of our 40 clients,
18 they denied 5 clients that have flat out patents or
19 applications of patents. That makes absolutely no sense
20 whatsoever to deny planets -- patents for any reason.
21 Period. Period. Period. What they've done is they've
22 eliminated the tax that the legislators have given. They
23 simply, by denying everything, have eliminated the -- the
24 credit.

25 We have Senator Chuck Grassley from Iowa a couple

1 of months ago issued a video saying, please, please,
2 taxpayers, we -- we need you to submit these requests for
3 tax credits because it's so important to get your business
4 going, especially, since this was a period of -- of COVID.
5 Companies needed to do certain things. And it's a great
6 incentive in the law. And it's just not fair to eliminate
7 the law.

8 Number four, all -- virtually every client. They
9 have pushed hard for this concept, initial hypothesis
10 being accepted or rejected. Our clients are trying to
11 make their business better. They don't spend time to --
12 to denote what their initial hypothesis was, and how they
13 had to revise that hypothesis, and how there could be two
14 or three or four or five more hypotheses. They're wanting
15 to get the job done.

16 Number five, we talked about COVID.

17 Number six, if I'd gone through and done a lot of
18 important work to make my company better and show clearly
19 that I made a major process improvement or technic to my
20 company, that's the important thing. The important thing
21 is I've achieved that. Why would the FTB not ask, did
22 this -- did these new improvements add to y -- they don't
23 ask did they add to your business? Did they improve? Did
24 you get new sales? Did you -- did you reduce your cost?
25 No. They're not concerned at all about what the client

1 did to improve his business. That's the only thing that's
2 important. All this other stuff about uncertainty and
3 hypotheses and documentation is 100 percent ancillary to
4 the objective of getting a major process improvement or
5 technique for the company.

6 Number five -- number seven, how many times they
7 rejected -- the FTB rejects? It says oh, you've done lots
8 and lots of work, but it's a mere -- mere implementation
9 of existing technology. They're right. Yes. Yes, we did
10 use the existing technology, but we did improve it.
11 It's -- it's not mere; that the word "mere" makes no
12 sense. If you implemented an important new concept to
13 your company, you don't reject it because you did use some
14 of the old parts of it. So that's -- that's just a --
15 nonsense argument that -- that flies throughout all of our
16 40 clients.

17 Number eight, with respect to the check, how does
18 the taxpayer react to the fact that they get -- that they
19 submit three tax returns, the IRS submits the check
20 without any -- any question or any problem; that the IRS
21 not only rejects it, they reject any possible explanation
22 given by the -- by the taxpayer. Very frustrating.

23 Finally, our company works generally with
24 companies that are \$2 million less. Mr. Michaels, I
25 believe, is around the \$2 million -- he can clarify

1 that -- in annual sales. These companies, as he's done,
2 submit \$10 or \$20,000 for -- for three years. They have
3 \$50,000 that they want -- that the FTB wants them to pay
4 back. Let's say they add another \$10,000 in penalties and
5 interest. They're going to ask these companies for
6 \$60,000, which may represent two years of their -- of
7 their profits, when this -- when the company had every
8 expectation that these credits would be approved because
9 number one, they had good information.

10 Number two, as I didn't mention before, that for
11 15 years prior, they never asked for all this information.
12 So how -- so if -- if they're never asking for
13 information, how do we pivot 180 degrees and ask for 7 to
14 15 pages of detail -- detailed information? It doesn't
15 make any sense whatsoever to any of our taxpayers. So, I
16 think based on this fact -- these facts you could see our
17 frustration. If I -- if -- if anything I'm saying is
18 incorrect, they should -- I'm sure they'll correct me.
19 But to the best of my knowledge, all these statements are
20 100 percent absolutely true.

21 And that's -- that's what I have to say for now.

22 JUDGE KLETTER: And, Mr. Sekula, do you plan on
23 having Mr. Michaels explain the projects, or are you going
24 to --

25 MR. SEKULA: Yes, I think he should. I think he

1 should because you take the situation, again, with that
2 four-part test, it's very complete and very thorough
3 showing what he did, but he can amplify it. And when --
4 when you talk about artificial intelligence that he used,
5 that's something everyone isn't familiar with. But it
6 would seem absurd to say that there's no uncertainty with
7 respect to using artificial intelligence. How -- how
8 can -- how can anyone -- how did they make that -- how can
9 taxpayer take that kind of abuse to say that -- that
10 there's no uncertainty in using artificial intelligence?

11 So, I definitely would like him to -- to show
12 that -- that we're serious. We've -- we've done research
13 here, and he can -- he wants -- he said this principle.
14 This isn't a huge amount of money to him, but he's a
15 successful person. He wants to show you that he -- he
16 wasn't giving the FTB garbage. He was giving them good
17 information, and we're very frustrated when -- when they
18 reject everything out of hand.

19 You want to go ahead, Patrick?

20 MR. MICHAELS: I'm ready to speak, if that's
21 okay.

22 JUDGE KLETTER: Please go ahead.

23

24 WITNESS TESTIMONY

25 MR. MICHAELS: I'd like to introduce myself first

1 of all. I'm an environmental hygienist, registered
2 environmental assessor with the State of California. I've
3 been involved with environmental projects for over
4 40 years. And when I say environmental projects, my job
5 is protecting people from toxigenic materials,
6 carcinogens. I deal with things that hurt people. I'm a
7 senior project scientist with the Navy and Marines. They
8 have a program called the Other Environmental Liabilities
9 Program. I have worked for the local air quality
10 management districts. They have hired me independently to
11 do investigations for them.

12 I have a laboratory that is government accredited
13 through the National Institute of Standards and
14 Technology. They thoroughly audit me every two years to
15 assure compliance with bible-size regulatory standards.
16 That's who I am, and that's how I operate. I am a small
17 business. At best in the past, I've had 13 employees.
18 Things change overtime. I've been doing this 40 years as
19 an independent -- as an independent businessman. And yes,
20 I am below \$2 million in the overall generation of income.
21 And as an expert -- I've been in 50 or 60 different
22 cases -- I make \$500 an hour.

23 So, this is -- I'm not here for \$10, \$11,000 or
24 whatever. That's -- that's not why I pursued this. I
25 pursued this because I, in good faith, submitted

1 information and actually engaged in research specifically
2 because I became aware that I could be reimbursed what
3 would otherwise be total out-of-pocket cost. Because most
4 of my research, if not all of it, at least during that
5 time period, I put money out for a microscope, for
6 example, that is not standard.

7 It's a microscope that operates by scanning at
8 400 magnification over a microscope slide so you have
9 moving parts. You have it taking photographs of -- of
10 biological entities, basically, mold, spore, and funguses.
11 And then I am looking at this after it scans the slides,
12 and then I have to look at all of the pictures to train
13 the A.I. And I'm gonna backwards because right now A.I.
14 is a big thing. And I'm not invested in A.I. I was then
15 only because I was involved it -- with it.

16 But, at that time, we're talking 2019, 2020, A.I.
17 was nascent. You did not have these big stock runs like
18 you do now over it. And what most people don't understand
19 about A.I. is, somebody like me is behind the scenes
20 training it. So, I'm here looking at -- actually, looking
21 at what the A.I. is viewing on the pictures that the
22 microscope is taking and saying to the A.I., yes, this is
23 a Cladosporium spore. Or yes, this a Stachybotrys spore.
24 Or nom you got it all wrong. And with the spores, for
25 example, they have different life cycles. So, they look

1 different at different times.

2 It does take somebody like me who analyzes under
3 the microscope -- and I am an expert in asbestos, and I'm
4 an expert in mold, and I'm an ex -- I have done expertise
5 with gases and other things. But takes somebody -- a
6 human to train these machines. And more often than not,
7 at least during the time period when the A.I. was -- was
8 young, I was spending a lot of time. And I had
9 assistants, and I paid them to run the machines. But then
10 I would have to go back and review everything. So,
11 whereas I might take a half hour to analyze a sample, now
12 I'm having a machine do it. Then I'm going through the
13 pictures that the machine takes and characterizes, and I'm
14 saying no, it's this. No, it's that. This is not at all.

15 So, it was a lot of work, and it was a lot of
16 money. And like I said, I think the scope I bought was
17 somewhere between \$15 and \$20,000 just to do that, and I
18 can't use it. It's not something that I can provide to
19 the public a service with because it's untested because
20 I'm testing it. The advantage of it however, would be --
21 and it's like A.I. today -- that okay, I wouldn't have to
22 train the analyst that I take two and four years to train.
23 The computer is already trained, and I would merely have
24 somebody prepare a slide and put it under the microscope;
25 and then it would analyze it. And I would be assured. I

1 would -- I would know by that point that it does its job
2 as well or better than I do.

3 And it's somewhat ironic at this point in time,
4 for me personally because recent -- my mother is a breast
5 cancer survivor. And I'm not bringing this up for
6 sympathy. She's a -- she was a professor at UCLA. My
7 father was a D.A. for 26 years. She retired when -- from
8 CSUN. And she recently went to Kaiser and had a scan.
9 And these scans are the same thing I was doing. But
10 instead of a microscope, it was either a -- was using
11 radiology or some other method. And she was cleared, but
12 they submitted the samples to -- the scans to A.I., and
13 they found that she had two growths that were not caught
14 by the humans. And this is exactly what I was trying to
15 do with the mold; make them more accurate method because
16 it is tedious to sit look at particles under a microscope.
17 And that is just with the mold, the A.I. intelligence with
18 mold, and there are many parts to that. It's not just
19 looking at the screens afterwards. That is one thing.

20 The other thing I was utilizing and looking at
21 was PCR analysis of the dust in my clients' houses. Now,
22 I have clients who come to me, as a detective more or
23 less, and say my child or myself we are having these
24 problems, and we think it's related to something
25 environmental. And so, I will go through the list and

1 say, kind of like House or one of those movies or
2 whatever, and say, what about this? What about that?
3 What about the other thing?

4 Well, one of the tools that I found was not being
5 utilized as it can be was PCR DNA analysis of dust in
6 people's residents for the biological mold spores and
7 fungi that they're breathing. And so, I introduced using
8 this as a technique to determine the actual type of mold
9 that they're exposed to, and then seeing if their -- what
10 their -- what their experiences are relate to the
11 mycotoxins within this mold. So, for example, I have a
12 case right now.

13 Somebody in Beverly Hills paying \$26,000 a month
14 for a house that was not well maintained by the owners
15 began breathing, they believe mold; saw some. I
16 investigated. I went in, determined the types of mold in
17 the dust by their DNA, and then I was able to correlate
18 the specific types of mold that caused the infections that
19 these people were experiencing so that their doctors could
20 then come in and do what they needed, either through IGE
21 tests of the levels of response in their -- in their blood
22 or through urine test of the mycotoxins that they have
23 within them, all of this. And then there's more. There's
24 more, but I don't need that much time. You see where I'm
25 going with this. As well as the -- using infrared to

1 determine the extents of microbial growth within walls
2 that you can't see with your own eyes. That's another
3 thing that I applied for it here.

4 So, I spent this extra money. I bought this
5 extra equipment, infrared meters microscopes paying for
6 PCR DNA analysis that, otherwise I would not have probably
7 taken. Because I knew that the research and development
8 and the credit that was given to me would offset what
9 otherwise could have been a loss -- would have been a
10 loss, an is a loss at this point, that I might not have
11 taken that risk if not for this. And the reason I started
12 any of this -- and I've been doing research all of my
13 years. I mean, I was on the front page of the LA Times
14 for disturbance of toxigenic materials in front of
15 schools, in people's houses, and telling the people to get
16 out. You're unsafe. Don't take anything with you. I was
17 in the daily news in the San Fernando Valley, California
18 for the same reasons.

19 I was in the Ventura County Star Free Press for
20 schools that I went into and found some problems, and this
21 is all research. This is not based upon existing laws and
22 knowledge that we have. These are things I've had to put
23 together. But then I found that when I talk to my CPA one
24 day, what other things are out there for somebody in my
25 field that might allow me to branch out and do more. And

1 then my CPA told me. She told me, and she said look,
2 there are research and development credits. And I said
3 wow. Okay.

4 I didn't know what the recordkeeping requirements
5 were or not. Normally, my files are kept for three years,
6 except for tax related items. So I get this response to
7 my claim from the FTB a few years later then I put them
8 in. And I'm like, oh my God, you know, there's so much I
9 could go through. There's so much I could get. But I'm
10 dealing with all kinds of other things. And if I -- they
11 would have just -- if I would have just known they you --
12 they needed that form of documentation, the type that I
13 use when I'm doing a -- a -- a investigation for the EPA
14 or the AQMD, I would have done it. But I might not have
15 even gone for the incentive if it was overburdensome as
16 this feels to me now. But I don't need the money, but
17 there's no reason for me to come here and say somebody
18 should say something. So that's -- you can question me as
19 you will, but that's where I'm coming from.

20 JUDGE KLETTER: This is Judge Kletter. Thank you
21 Mr. Michaels.

22 I just want to ask, Mr. Sekula, did you have any
23 questions that you wanted to ask of the witness before we
24 turn it over to our panel questions and check with FTB if
25 they have any questions for the witness?

1 MR. SEKULA: No, I don't have any questions for
2 Mr. Michaels. That was a good presentation that he made.

3 JUDGE KLETTER: Great. So, I just have one
4 confirming question for Mr. Michaels.

5 What we have in the record is a credit study, and
6 the credit study is addressed to Patrick Montoya. And I
7 just wanted to confirm with you, is that, like, a typo?
8 Is that someone else or who is Mr. Montoya?

9 MR. MICHAELS: So, I have a -- two names,
10 basically. Patrick Michaels and Patrick Michaels Montoya.
11 So yes, on my tax forms you're going to see Montoya. My
12 business literature is Patrick Michaels, and that's been
13 consistent since 1984.

14 JUDGE KLETTER: Noted. Thank you.

15 I am going to actually turn it over to Franchise
16 Tax Board, and ask Franchise Tax Board, do you have any
17 questions for Mr. Michaels?

18 MS. KUEHL: We do not have any questions.

19 JUDGE KLETTER: Okay.

20 And then I'm going to turn over to my panel.
21 Judge Famularo, do you have any questions for
22 Mr. Michaels?

23 JUDGE FAMULARO: I do.

24 Hello, Mr. Michaels. Mr. Michaels, I have a
25 question about the timeline that happened in this case.

1 We're talking about amended returns that were filed for
2 two years. And you mentioned that you were incentivized
3 to conduct the projects at issue because the research and
4 development credits, but you filed the amended returns for
5 those credits. I was wondering if you could elaborate
6 what you meant when you said that you might not have
7 undertaken these projects but for the R&D credits.

8 MR. MICHAELS: So, when I spoke with my CPA, she
9 said to me, "Are you doing any type of research and
10 development?" And, of course, now we're talking two years
11 here, right. So, the initial year I did not even know
12 that I had any rights to any credits for my research and
13 development. And so thus, you have amended returns. And
14 then the following year was not amended returns. But yes,
15 I found that yes, I can get research credits.

16 Now, would I have gone as far as I did had I
17 known about this prior? Probably not if I was not -- if
18 it was just a denial situation, there's -- there's no
19 incentive for me to go further. I've always been a trail
20 blazer in my field. I mean, with transmission electron
21 microscopy, before anybody was using it for asbestos --
22 and I'll explain that the difference with transmission
23 electron microscopy is that we're looking at invisible
24 particles to the naked eye. Most -- for example with
25 asbestos, which is a carcinogen, most of the time with

1 local regulatory agencies, if we see lay -- pieces of
2 asbestos laying around, something we know as asbestos, we
3 call it contamination. You can see it with your eyes.
4 Pieces of ducting or somebody's popcorn ceiling. But
5 exposure can be to invisible amounts. That's why the
6 airborne test that we use for schools use TEM
7 specifically. They're required to use TEM 'cause you can
8 see 30,000 magnification seeing invisible particles
9 floating in the air.

10 So I took this and said we can use this in the
11 dust to see what the layer and the buildup is and try to
12 correlate that to somebody's exposure. So like I said,
13 I've always been a forward thinker in this field, and I --
14 I utilize it in my practice as an expert with attorneys.
15 But to incentivize me to do it on my own, within my money,
16 within my own company, I saw this as an opportunity.

17 JUDGE FAMULARO: Okay. Thank you, Mr. Michaels.
18 I just want to clarify. So, when you said that you spoke
19 to your CPA about the R&D credits, is that in 1999? And
20 specifically, you know, around what -- you know, if you
21 can give us a general estimate about what time that
22 occurred, I think that might be helpful.

23 MR. MICHAELS: I know that I'm dealing with two
24 tax years here, and is this -- is way back for me. We're
25 dealing with, what, 2020 and 2019, right? Yeah. When the

1 year -- the tax year that I learned of the credit for
2 research and development was, obviously, the 2019. And
3 when I learned there was such a thing, that applied for it
4 because I'm doing it. And in the following year, I even
5 expanded it thinking that, okay, great. It will open my
6 horizons more.

7 For example, on the -- on the side of the A.I.
8 intelligence for mold, yes, I could make some money on
9 that. I could make some money because it would not
10 require an analyst. As we all know that's the issue with
11 A.I. now. It's going to replace somebody. But, at the
12 same time, I could also do more work. So I expanded once
13 I knew that this research and development credit existed.
14 I expanded my work, but I also took credit for what I was
15 already doing, not even knowing that I had a credit that
16 could come to me.

17 JUDGE FAMULARO: Okay. No. I appreciate that.
18 So, why was there a delay in pursuing the credit study
19 that you used to establish the projects and the qualified
20 research that you're taking a position supports, the
21 credit for each of the five projects listed in the credit
22 study?

23 MR. MICHAELS: First of all, it's hard for me to
24 remember that far back and the specifics. I went to my
25 CPA. My CPA referred me to a company that specializes in

1 this type of situation. And then I took the time to go
2 through what I was already doing that was unique or not
3 standard for our industry and put together. It did take a
4 long time to go through the paperwork I was presented and
5 put all the answers to the questions together. 'Cause I'm
6 running a company at the same time that I'm trying to
7 then -- when I -- and I could not delegate this. I have
8 nobody else.

9 I'm a small business. At the time, 7 employees,
10 I think -- 4 -- maybe 7. At one time I had 13, but 7 --
11 maybe 4 of which are in the field, three of which were in
12 the office, one of which is helping me in the lab. So,
13 I'm doing a lot of stuff. But getting the questionnaires
14 and looking up, actually having to research the times
15 where we worked on these things, it took a lot of effort
16 and took a lot of time. So, I don't remember the exact
17 timeline there, but I do know it took a lot of effort and
18 time just to put the package together.

19 And then after I put the package together, it was
20 reviewed and scrutinized by the company I hired, Business
21 Incentive Solutions, to make sure that it's in compliant.
22 And then if wasn't compliant, I needed to know. But to my
23 knowledge, everything was in compliance, and I felt good
24 to go at that point.

25 JUDGE FAMULARO: So, with --

1 MR. SEKULA: Can I clarify on the timeline? Can
2 I clarify on the timeline?

3 JUDGE FAMULARO: Go ahead.

4 MR. SEKULA: Yeah. I think what happens here is
5 we -- our company. This is Business Incentive Solutions.
6 When we went to him, he had already filled out the 2019
7 tax return. He was in the process of 2020, and we had to
8 spend a lot of time talking to him about what he had done
9 and make sure that we could submit this fairly extensive
10 tax credit study. So, by that time, again, he already had
11 submitted 2021.

12 So we were -- we were well into 2022 or sometime
13 in 202 -- I'm sorry -- before we could get this stuff
14 together to request the credit. So, obviously, it was --
15 it had to be an amended credit to go back. So he -- he --
16 he was -- he was hoping to get the credit as soon he
17 could, 2019 or 2020, but we couldn't actually put it
18 together until 2021.

19 JUDGE FAMULARO: Okay. I appreciate the
20 clarification.

21 I have a separate question for you, Mr. Michaels.
22 So, in the credit study for the methodology, it mentions
23 that the methodology is reliant on your oral testimony,
24 and that you stated that you could support the testimony
25 with contemporaneous documentation. And, to my knowledge

1 and looking at the record, I don't see that
2 contemporaneous documentation. And I wanted to provide
3 you an opportunity to clarify what you meant by that and
4 explain whether that information has been provided to
5 Respondent.

6 MR. MICHAELS: I was asked by Mr. Sekula to
7 provide examples of the type of work I did, and I was able
8 to provide examples of that work. But the examples are
9 closer in timeline to now than 2019 because, frankly, I
10 just haven't been able to even go back. Like I said,
11 normally, we only keep our records, and this is part of
12 our government accreditation as a lab as well. Our
13 records are officially only kept for three years when it's
14 non-financial related; so, people's reports and surveys.

15 So, I rely upon them to maintain those, and then
16 I can later state that yes, I did produce those. But we
17 don't have the means to store that much information to go
18 back to 2019, six years ago or five years ago, whatever.
19 It's really burdensome at this point.

20 JUDGE FAMULARO: What about emails, lab results,
21 and other types of data that wouldn't involve your
22 clients? Do you have that information, and is that
23 something your company maintains?

24 MR. MICHAELS: I would have -- yes, I do have
25 receipts for paying outside labs for the type of tests I'm

1 talking about. I could provide those. However, a lot of
2 the work I did was out of charge. I didn't charge clients
3 for it. So, I mean, I have receipts for the microscope,
4 for example, that I purchased. I -- I provided
5 information on payroll for the people who worked with me
6 and for me. I'm just saying it's real -- yes, I could dig
7 up some things. It would -- it would take some time. And
8 this -- I was not aware I needed that for the purpose of
9 this hearing, and so I have -- I have only provided some
10 reports to Frank Sekula that show the type of work I was
11 describing in 2019 and 2020, that I continue it on now
12 after starting it back then, except for the A.I.

13 I have to say except for the A.I., with the
14 microscope, that turned out eventually to not be
15 adequately accurate for me to utilize on a daily basis.
16 So, I had to shelve it for the time. It probably now it
17 would be a much better situation because of how far A.I.
18 has come. But at that time, you know, with the -- for
19 example, the readers of license plates and faces and all
20 that we're so far advanced from 2019 when I was doing this
21 over particles and -- and fungal spores, that it probably
22 would work now. But I don't have the extra funds nor the
23 incentive to jump back in and try to make it work.

24 MR. SEKULA: Judge, can I clarify again? Judge?

25 JUDGE FAMULARO: Sure. Yes. Please, go ahead.

1 MR. SEKULA: The -- the comment we -- we had made
2 is because all this contemporaneous information had not
3 been required for 15 years or longer. We didn't take the
4 time or effort to -- to do it. And even if we would, when
5 you have 3 or 4 or 5 years go by, you're -- you're not
6 going to have things. It's been very difficult. I can't
7 find stuff from one year ago, let alone five or six years
8 ago, even if I would have gotten them.

9 Now, you could argue we -- we maybe didn't do
10 as -- as a good a job on that, but the research they did
11 is very, very clear; as he's explained to you in spades,
12 very, very clear research, and that's the key. There's no
13 doubt he did the research as I mentioned before. It'
14 ancillary the documentation. And what if he didn't have
15 documents? What if he didn't have emails? Now, would you
16 accept the receipts for the microscope that he used in the
17 research? Would you accept that, the microscope receipt?

18 JUDGE FAMULARO: So, I mean, with respect to, you
19 know, any type of documentation like that, it's something
20 that I can't advise you right now.

21 MR. SEKULA: No. I understand.

22 JUDGE FAMULARO: That you, you know, whether
23 that's something you should provide and meets the
24 requirements of the law. But, you know, in general, I can
25 tell you that any kind of documentation -- contemporaneous

1 documentation, including purchase of equipment -- during
2 purchase of equipment in those two years, in 1999 and
3 2000, would be -- would generally be relevant.

4 MR. SEKULA: So, I'm sorry we didn't submit
5 those. But again, I've been repeating myself for about
6 the fourth or fifth time. If it hasn't been asked for for
7 15 years, why would you not assume that when you give
8 reports that are crystal clear that they would need to be
9 supplemented by all this contemporaneous information?
10 Yeah, after the fact, you could say, yeah, you should have
11 done it. But put yourself in our shoes. We're not being
12 asked for this stuff, and there's a 180 degrees change for
13 no reason.

14 No one -- no one has ever alerted us that we do
15 this. The IRS hasn't asked for it. Now, it's -- this --
16 this is hammered over our head that we can't approve --
17 we can't approve any of our clients' request, because you
18 could see how absolutely in tune he was to -- to
19 responding to the -- the spirit and the intent of the law.
20 And now, the FTB is going to deny everybody because of the
21 documents that -- that are five or six or seven-years old.
22 That -- that does not seem that credible.

23 MR. MICHAELS: I'd like to make a clarification,
24 if you don't mind?

25 JUDGE FAMULARO: Yes, go ahead.

1 MR. MICHAELS: In a single year my lab would
2 analyze maybe 2,000 sets of -- for example, mold samples.
3 Okay. And a set is not one. It can be, but it's usually
4 2, 7, 10 samples, and not all of those were involved in my
5 research and my work. That becomes a problem to go
6 through all the sets and say this one was for this and
7 this one was for that. It also is the same case when it
8 goes to the PCR on projects. Not every project that I did
9 -- and we're talking hundreds that I do a year, maybe
10 thousands of projects-- me and my employees where mold is
11 involved, not all have PCR involved.

12 Sometimes, for example, I use PCR DNA analysis
13 for a certain type of mold that's called a house-eating
14 fungus. It cannot be identified by spore types or even by
15 most people the way it looks. I happen to be one of the
16 few people that can identify it by field observations.
17 But when I need it for legal purposes, I have to take a
18 piece of that mold and send it in for DNA analysis to tell
19 me that is Poria, the wood-eating mold, the house-eating
20 fungus.

21 So, the other issue here is that the number of
22 projects during these years, for me to go back and sort
23 through, it becomes very -- even more burdensome.
24 Because, yes, it's not -- just not some not like I have an
25 explicit list of this one here, and that one there, and

1 this one. I would have to go through digging back, and
2 it's -- it's overly burdensome if you ask me for what
3 we're doing here.

4 If I knew to begin with, that would have been
5 different. I would have kept an exact log like I do for
6 my governmental work. But I provided everything I thought
7 I needed to -- to the government for this purpose. But I
8 just wanted to clarify there's a lot of work I do, a lot
9 of work that my company does. And specifically, me when
10 it comes to the more identification because I hold the
11 licenses. I hold the certs. Most people can't go out and
12 do what I do without my licenses. And the people who work
13 under me, most of them, cannot do what they do under me
14 without my license because I have to oversee them.

15 So, there are thousands of projects that we're
16 talking about here. That's why, when I'm thinking about,
17 oh, can I give you something contemporaneous, yes. It
18 would take a lot of work now -- now to go back and do that
19 for you.

20 JUDGE FAMULARO: Okay. I appreciate that. And,
21 Mr. Michaels, I just wanted to ask one more clarifying
22 question about your initial testimony. One of the
23 requirements for the research credit is an elimination of
24 uncertainty regarding the development of -- or development
25 or improvement of a product. And I heard you speak about

1 the issues and the need to conduct these projects
2 generally. I wanted to ask you if you could, by each
3 specific research project, identify what specifically you
4 identified as the uncertainty in the process to develop or
5 improve those projects?

6 MR. MICHAELS: Okay. So, let's take the A.I. and
7 mold. Studies, the research exists that show that taking
8 the same sample for mold analysis and providing it to
9 different labs and seeing their results as a wide range of
10 difference between lab to lab. Taking the same sample and
11 providing it to the same analyst on separate occasions
12 also has a wide differentiation in their findings. There
13 are a lot of reasons for that. I mean, I thought my
14 testimony is going to be about 30 minutes, but I -- I
15 could turn it into 6 hours.

16 But there's a wide difference in analysis,
17 especially of mold spores. So, there's a great
18 uncertainty between analysts, unless -- and -- and this is
19 the only unless -- unless there's an extreme finding. For
20 example, if you have a sample where there's 10,000 spores
21 per cubic meter of a certain type of mold, a couple of
22 spores difference is not a big deal. But when we're
23 talking about one analyst saying, oh, I saw 30 spores of
24 this type, and another one saying I saw 300; that can be a
25 big difference.

1 And I was hoping to train the A.I. to take that
2 differentiation out because I think it has the
3 capabilities of some of the things that humans fail at,
4 that it would be able to take that into account.
5 That's -- that's one.

6 On the TEM site, the dust particle analysis for
7 contamination and asbestos, you have a situation here
8 where somebody lives next to a freeway. And most people
9 don't know, but asbestos is not yet banned. It's not
10 fully banned. There are a lot of uses. One is clutches,
11 brakes, so mechanical means. And so, you have somebody
12 who is claiming contamination in their house but yet,
13 they're next to a freeway. Using TEM I need to know how
14 to differentiate that. As a matter of fact, what I was
15 working on was using the TEM method as a fingerprint for
16 asbestos.

17 Because the way TEM works is they take a sample.
18 They put it under a transmission electron microscope,
19 which goes up to 30,000 magnification. It's in a vacuum.
20 They shoot electrons at it, and they come up with a
21 scattered area electron display. Then they shoot X-rays
22 at it, which gives a X-ray diffraction reading, and with
23 that tells you two things: One, what is the crystal
24 structure; what is the chemical make-up of that an X-ray
25 defraction reading. And what that tells you is two

1 things. One, what is the crystal structure; two, what is
2 the chemical makeup of that asbestos fiber.

3 And I was working on trying to match, like a
4 fingerprint, the chemical and crystal structure of that
5 fiber with the known asbestos materials in the house; so
6 when it come to the asbestos side of things so that, okay,
7 that contamination is actually from inside the house, not
8 from the freeway next door. Or if there was an event next
9 door, maybe someone broke their house down and disturbed
10 the asbestos. I could take a piece of that and match it
11 with using TEM the SAED and the XRF on that, right. So,
12 these are uncertainties I'm trying to solve.

13 When it comes to the infrared, one of the biggest
14 issue is I'm looking at a wall, and I can't see through
15 it. So, I use these other methods to see something that
16 can distinguish something in the wall. So, using an
17 infrared I'm going to see, all right, why is that portion
18 of the wall wetter than the next portion of the wall? It
19 allows me to then say okay, maybe locate a source from
20 which intrusion of moisture causing fungal growth is
21 coming in. Or it allows me to see how extensive is this
22 fungal intrusion because this wall is still wet after such
23 and such time from the event. Okay.

24 So, when it comes to the measures of uncertainty,
25 that's in a summary what I was saying in my documentation

1 that I was working on. And I'm further along, but I'm not
2 done. I'm not -- there's still more work to do.

3 JUDGE FAMULARO: Okay. I appreciate that. You
4 mentioned three of the five projects. I think there are
5 two remaining. One is -- and you briefly mentioned the
6 microscope platform the X-Rapid Group, hands-free
7 microscope platform, and then the last one being the
8 polymerase chain reaction testing raise, the fifth
9 project.

10 MR. MICHAELS: Okay. So, let's go to the PCR.
11 That's where I was talking about taking the dust in the
12 house and checking the DNA of the fungal spores within
13 that dust. And the uncertainty of that is this. We are
14 exposed to mold all day, every day to some extent. We
15 don't know which of the 30 different types of Cladosporium
16 or asparagus penicillium you're breathing out there in the
17 natural environment. So, what we can do is compare. The
18 uncertainty is, what is the mold that's coming from
19 outside the house? What is the mold that's being found
20 inside the house? And that comes down to speciating the
21 mold.

22 Because stachybotrys, for example, is called the
23 black mold. It's a type of mold that produces a mycotoxin
24 that's similar to chemical warfare agents that we have
25 produced in the past. People breathe it. The theory is

1 that they breathe it. It dissolves in their lungs, and it
2 releases this poison into their lungs and causes
3 debilitating diseases. And I have clients who have these
4 diseases. But there's more than one type of Stachybotrys.

5 In that case it's pretty straightforward. But
6 when it comes to Cladosporium, then it's mostly -- it is
7 allergenic in all cases, but mostly innocuous for -- for
8 producing toxins. But there are a couple of types of
9 Cladosporium that do produce mycotoxins. And that's
10 relevant to somebody in their house to see if the event
11 that occurred in their house that they think is affecting
12 them, if those mycotoxins, that type of Cladosporium is
13 present, not the type that's outside degrading your
14 vegetation so it turns into fertilizer.

15 So, to take away that uncertainty we would use
16 the PCR method. And I've already explained when it comes
17 to the microscope why there's a difference. There's the
18 uncertainty in the analysis based upon lab to lab and
19 analyst to analyst that if we had an adequate A.I.
20 situation -- just like my A.I. on my computer reads my
21 face, facial recognition -- mold spores analyses are based
22 upon morphology, which is exactly what facial -- we're
23 talking about with facial recognition. We're talking
24 about different points that unique to different mold
25 spores.

1 I'll give you an example that I give to clients.
2 Aspergillus and penicillium we report them the same under
3 standard tests because we cannot look at them and see the
4 difference. Both of them look like a clear marble. They
5 look like a bubble. That's what they look like, exactly
6 like a round bubble. Some of them are a little browner
7 colored, some are clear; but they all look the same shape,
8 and they have variations in color. But if I want to tell
9 somebody this is Aspergillus and this is penicillium,
10 which is the same as penicillin that we have as a
11 bacterial fighter, I need to set -- be able to do a test
12 that could say it's this kind of Aspergillus. It's this
13 kind of penicillium we're working with here. And nothing
14 but the PCR could do that. So, these are the
15 uncertainties that what I'm working with are trying to
16 solve.

17 JUDGE FAMULARO: Thank you, Mr. Michaels. I have
18 no further questions.

19 JUDGE KLETTER: This is Judge Kletter. I'm going
20 to turn it over to Judge Long.

21 Judge Long, do you have any questions for
22 Appellant or the witness?

23 JUDGE LONG: I have no questions. Thank you.

24 JUDGE KLETTER: Okay. So, I am going to actually
25 turn it over to Franchise Tax Board.

1 Franchise Tax Board, you'll have 20 minutes for
2 your presentation. And if I could just ask you, if you
3 make citations to law, if you could please spell out the
4 names to help our hearing reporter. That was the attempt
5 of my order to ask for proper names. Just please spell it
6 out to aid in transcription the first time that you
7 mention it. So, you'll have 20 minutes.

8 Ms. Kuehl, are you ready to begin?

9 MS. KUEHL: Yes.

10 JUDGE KLETTER: Please go ahead.

11

12 PRESENTATION

13 MS. KUEHL: Good afternoon.

14 For its 2019 and 2020 taxable years, Appellant
15 claims to have engaged in research qualifying for the
16 California research credit. Just to clarify the timeline
17 for the panel, Appellant's original 2020 California tax
18 return was filed on May 11th, 2021, and Appellant did not
19 claim the research credit. We would be happy to provide a
20 copy if needed. Appellant filed California amended
21 returns in June of 2022 for taxable years 2019 and 2020
22 claiming California research credit. However, Appellant
23 has failed to provide sufficient evidence to substantiate
24 its claim to research credit.

25 Under Internal Revenue Code section 41, taxpayers

1 must establish three primary elements: First, taxpayers
2 must substantiate that they performed qualified research
3 activity. After demonstrating that they engaged in
4 qualified activity, taxpayers must substantiate the
5 expenses related to such qualified activity. Finally,
6 taxpayers must substantiate their fixed-base percentage
7 and base amount for computing the proper amount of credit.
8 If taxpayers fail to establish any of these elements, they
9 are not entitled to the credit.

10 With the respect to qualified research activity,
11 section 41(d) defines qualified research as research
12 activity which meets four distinct tests. First,
13 expenditures connected with the purported research
14 activities must qualify as research or experimental
15 expenditures under Internal Revenue Code section 174.
16 Second, the research must be undertaken to discover
17 information that is technological in nature. Third, the
18 research must be intended to discover information that is
19 useful in the development of a new or improved business
20 component. And finally, the taxpayers must show that at
21 least 80 percent of the claimed activity involved a
22 process of experimentation for a qualified purpose.
23 Failure to establish any of these four elements also
24 results in the taxpayer's failure to claim any credit.

25 At its core, this case is about substantiation.

1 A taxpayer claiming a credit under section 41 must retain
2 records in sufficiently useful form and detail to
3 substantiate that the expenditures claimed are eligible
4 for the credit. Here, Appellant has provided no
5 documentation substantiating that it actually engaged in
6 the activities that it claims to have performed.
7 Appellant's failure to substantiate its activities is
8 dispositive of this appeal. Nonetheless, Appellant's
9 claims fail for several other reasons.

10 Appellant has failed the four-part test.
11 Appellant has also failed to substantiate its purported
12 research expenses and has further failed to establish a
13 nexus between purported research expenditures and the
14 claimed activities. Finally, Appellant has failed to
15 provide documentation establishing that it properly
16 computed its fixed-base percentage and base amount for
17 computing a credit.

18 To satisfy part one of the four-part test under
19 Internal Revenue Code section 174, the research activity
20 must be research and development in the laboratory sense,
21 such that one, and uncertainty exist and two, the activity
22 is intended to discover information that would eliminate
23 this uncertainty. To establish uncertainty, the taxpayer
24 must show that information available to it did not one,
25 indicate that the taxpayer was capable of developing or

1 improving the product; two, establish the method by which
2 the taxpayer would develop or improve the product; or
3 three, establish the appropriate design of the product.

4 If the taxpayer establishes that uncertainty
5 existed, the taxpayer then must show that it undertook
6 investigative activities to discover information intended
7 to eliminate the uncertainty. Appellant does not cite to
8 or analyze any evidence to substantiate that any of its
9 claimed projects satisfy the section 174 test. In *Betz*
10 *versus Commissioner*, spelled B-e-t-z, *versus Commissioner*,
11 the U.S. Tax Court analyzed whether a taxpayer's design of
12 certain machinery satisfied the section 174 test. The
13 taxpayer in that case provided copies of proposed designs,
14 purchase orders, drawings, and other underlying
15 documentation, which the court analyzed and holding that
16 the taxpayer had not satisfied the section 174 test.

17 Here, by contrast, there is no way to even begin
18 to evaluate whether Appellant has satisfied the section
19 174 test, because Appellant has failed to provide any
20 relevant underlying documentation that could be analyzed.
21 Appellant's credit study by itself does not establish any
22 qualified activity. It merely contains unsubstantiated
23 assertions. Appellant has simply not met its burden. As
24 set forth in the applicable code in Regulations,
25 Appellant's must provide actual documentation that

1 establishes qualified activity.

2 The taxpayer's requirement to provide
3 documentation substantiating its claimed research credit
4 has been affirmed by the OTA in several cases, including
5 Appeal of Pino, spelled P-i-n-o, and Appeal of First
6 Solar, spelled F-i-r-s-t, space, S-o-l-a-r, and several
7 others. The applicable authorities on both the state and
8 federal level are overwhelming clear. Appellants must
9 substantiate their activities through documentation.
10 Simply alleging that they performed certain activities is
11 insufficient to show entitlement to the research credit.
12 Appellant has failed to establish that it satisfied the
13 section 174 test with respect to all five of its claimed
14 projects.

15 To satisfy part two of the four-part test, the
16 taxpayer must establish that research was undertaken for
17 the purpose of discovering information that is
18 technological in nature if it fundamentally relies on
19 principles of the physical or biological sciences,
20 engineering, or computer sciences. The fact that
21 technology occurred in the background of the operations
22 does not satisfy the technological in nature test.

23 Appellant has failed to provide any relevant
24 underlying documentation which shows that any qualified
25 research activity was undertaken by Appellant in taxable

1 years 2019 and 2020. Without such evidence, Respondent
2 cannot evaluate whether that research was undertaken for
3 the purpose of discovering information that is
4 technological in nature. As stated before, Appellants
5 must substantiate their activities through documentation.
6 Appellant's credit study by itself does not establish any
7 qualified activity. It merely contains unsubstantiated
8 assertions.

9 To satisfy part three of the four-part test, the
10 taxpayer must establish that the research is useful in the
11 development of a new or improved business component of the
12 taxpayer. Activities related to the adaptation or
13 duplication of an existing business component are not
14 qualified research for purposes of the credit. Taxpayers
15 must identify all discrete business components upon which
16 qualified research is performed. Appellant has failed to
17 identify a singular business component within each of its
18 alleged projects. A business component is defined as a
19 product, process, software, technique, formula, or
20 invention in the statute and regulations contemplate
21 application of the four-part test to a single component,
22 not a conglomeration of component. Appellant fails to
23 identify discrete components for each so-called project.

24 For example, in project one, Appellant alleges
25 that it, quote, "Implemented unique techniques." And for

1 project two, Appellant alleges that it implemented, quote,
2 "State of the art systems." Appellant fails to identify
3 how many techniques or systems there were or precisely
4 what each alleged technique or system encompassed.

5 For project three, Appellant describes that they,
6 quote, "Researched numerous alternatives, tested and
7 implemented new unique process and procedures." On its
8 face, process and procedures appears to potentially
9 encompass both and alleged process and a method. In fact,
10 all of Appellant's project descriptions appear to
11 encompass potentially multiple business components.
12 Furthermore, inserting buzz words, like research and
13 alternatives and tested, does not constitute evidence of
14 such activity. Without substantiation, it is impossible
15 to determine precisely what the business components were,
16 and whether any activities related to such components
17 satisfy the remaining tests for qualified activity.
18 Appellant has failed the business component test.

19 To satisfy the fourth part of the four-part test,
20 the taxpayer must establish that substantially all or 80
21 percent of its research activities with respect to the
22 business component constitute elements of a process of
23 experimentation for a qualified purpose. A process of
24 experimentation has been interpreted to mean that the
25 taxpayer develops a hypothesis for how a new alternative

1 may develop a new business component, test the hypothesis
2 in a scientific manner, analyzes the results, and then
3 refines the hypothesis or discards it and develops a new
4 hypothesis. A qualified purpose is a purpose relating to
5 a new or improved function, performance, reliability, or
6 quality.

7 In Appeal of Pino, spelled P-i-n-o, the taxpayer
8 used broad and conclusory language to describe their
9 process of experimentation and did not provide sufficient
10 evidence to substantiate their claim. In its opinion, the
11 Office of Tax Appeals correctly held that merely stating
12 the existence of an evaluated process does not show that
13 the taxpayer actually engaged in that process, or that if
14 the process occurred, it was a qualified process of
15 experimentation under the law.

16 Similar to the other tests for a qualified
17 activity, Appellant has not substantiated any of its
18 research activities with underlying document. Appellant
19 has only provided a credit study which uses overbroad
20 language to generally assert that it performed testing and
21 research. Without underlying documentation, neither
22 Respondent nor this panel can analyze whether
23 substantially all of Appellant's claimed research
24 activities with the respect to a business component
25 constitute elements of a process of experimentation for a

1 qualified purpose. As such, Respondent's determination
2 should stand.

3 I am happy to answer any questions at this time.

4 JUDGE KLETTER: This is Judge Kletter. Thank
5 you, Ms. Kuehl. I do not have any questions. So, I'm
6 going to just briefly check with my panel before turning
7 it over to Mr. Sekula.

8 Judge Famularo, do you have any questions for
9 Franchise Tax Board?

10 JUDGE FAMULARO: No, I do not. Thank you.

11 JUDGE KLETTER: And, Judge Long, do you have any
12 questions for Franchise Tax Board?

13 JUDGE LONG: I have no questions. Thank you.

14 JUDGE KLETTER: Okay. So, since there are no
15 questions, Mr. Sekula, you will have five minutes to make
16 a final statement, rebut anything that Franchise Tax Board
17 raised, or if there's anything else you said or prepared,
18 this is your time. Are you ready, or do you have anything
19 you wish to add?

20 Oh, I'm sorry. I think you may be muted.

21 MR. SEKULA: Okay.

22 JUDGE KLETTER: Please begin.

23

24 CLOSING STATEMENT

25 MR. SEKULA: Yeah. If you take a look at the

1 regulations in a fairly simple manner for any taxpayer, if
2 you Google what's required, if you take a look at how to
3 apply for these credits through any service like ours, you
4 don't get the series of 20 or 30 or 40 really specific,
5 really hard things to -- to document and to prove and
6 to -- to go through her big laundry list, I -- I'm not
7 sure Google or any major company could -- could qualify
8 for the California tax credit. It's -- it's amazingly
9 overwhelming.

10 And to say that we're just using buzz words and
11 to say there's no business component when you're doing
12 sophisticated testing, it -- it's just so frustrating when
13 they slam the door and -- and hit you with just an
14 incredible amount of standards that would just be -- what
15 she just listed, who could ever, ever submit this? And
16 would they buy -- for \$10,000 would they take -- would
17 they spend 3 or 4 weeks trying to answer piece by piece by
18 piece what she was asking for? It's certainly
19 overwhelming and certainly unreasonable.

20 That's all I have to say.

21 JUDGE KLETTER: Thank you, Mr. Sekula.

22 I'm just going to check one last time with my
23 co-panelists.

24 Judge Famularo, do you have any questions for
25 either of the parties?

1 JUDGE FAMULARO: No, I don't.

2 JUDGE KLETTER: Oh, okay. And, Judge Long?

3 JUDGE LONG: I will ask one question, and this
4 goes for Appellants. So, I'm curious. When you're
5 referring to the regulations, is there a specific
6 regulation that you're referring to, or is it just the
7 regulations to the Internal Revenue Code in general?

8 MR. SEKULA: Is it for me?

9 JUDGE LONG: Yes, please.

10 MR. SEKULA: I'm sorry. I'm sorry. I'm saying
11 that would people are sitting down to apply for the
12 credit, would they have any hope of realizing that they
13 would be expected to make -- meet 20 or 30 hard standards
14 like this? Why -- why would a -- why would a taxpayer --
15 a \$2 million taxpayer ever, ever attempt to submit
16 anything to the FTB? Clear, clearly it would take them so
17 much time and effort to try to explain that 80 percent and
18 this initial hypothesis. No one would expect to have to
19 do that.

20 It's -- it's amazing what she went through. She
21 went through point after point. Everything is wrong.
22 The -- the client did nothing. He made a good-faith
23 effort. He's given you very specific -- really detailed
24 specific things about how -- how his work involved
25 incredible uncertainty and very specific examples of how

1 this testing was done by purchasing microscopes and doing
2 everything. And the FTB says every single thing is wrong.
3 I mean, it makes no sense for any client ever to submit a
4 tax credit to FTB. You would never win. They shut the
5 door.

6 JUDGE LONG: All right. Thank you. That --

7 MR. SEKULA: They shut the door.

8 JUDGE LONG: That concludes my questions. Thank
9 you.

10 MR. SEKULA: Thank you.

11 JUDGE KLETTER: Okay. So I would like to thank
12 the parties for their presentations today. This concludes
13 our hearing.

14 The panel will meet and decide this case based on
15 the documentation that's in the record and the testimony
16 that was present today considering your arguments. We
17 will issue our written decision no later than 100 days
18 from today. The case is submitted, and the record is now
19 closed.

20 And that concludes -- I believe that concludes
21 this hearing session. So, thank you, everyone, for your
22 time, and have a great rest of your day.

23 (Proceedings concluded at 4:02 p.m.)

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HEARING REPORTER'S CERTIFICATE

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

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

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

I have hereunto subscribed my name this 14th day of April, 2026.

ERNALYN M. ALONZO
HEARING REPORTER