

STATE OF CALIFORNIA

FRANCHISE TAX BOARD

PUBLIC MEETING

MONDAY, JUNE 26, 2023

10:47 A.M.

GERALD GOLDBERG AUDITORIUM

9646 BUTTERFIELD WAY

SACRAMENTO, CALIFORNIA

STENOGRAPHICALLY REPORTED BY:

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APPEARANCES

BOARD MEMBERS

MALIA M. COHEN
State Controller
(Chairperson of the Board)

ANTONIO VAZQUEZ
Chairperson
Board of Equalization

GAYLE MILLER
Chief Deputy Director of Policy
Department of Finance

HASIB EMRAN
Deputy State Controller, Taxation

ERICA GONZALEZ
Program Budget Manager
Department of Finance

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STAFF

SELVI STANISLAUS
Executive Director

CRISTINA RUBALCAVA
Board Liaison

JOZEL L. BRUNETT
Chief Counsel

SHANE HOFELING
Deputy Chief Counsel

DENIS ARMSTRONG

MICHAEL BANUELOS

JENNIFER BARTON

JESSICA CLAYTON

IRINA ISKANDER KRASAVTSEVA

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APPEARANCES CONTINUED

STAFF CONTINUED

ROGER LACKEY

DELINDA TAMAGNI

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ALSO PRESENT

WINDIE SCOTT, State Controller's Office

JON SPERRING, PricewaterhouseCoopers

CHRIS WHITNEY, PricewaterhouseCoopers

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1 SACRAMENTO, CALIFORNIA

2 MONDAY, JUNE 26, 2023, 10:47 A.M.

3 ---o0o---

4 CHAIRPERSON COHEN: Good morning, ladies and
5 gentlemen. I have to tell you, I love coming to the
6 Franchise Tax Board. It's always a vibe. Did you hear
7 that smooth jazz? Welcome to "Club FTB."

8 My name is Malia Cohen. I am the Chair of the
9 Franchise Tax Board, and I want to welcome you today.

10 It's good to see you, to my left, Mr. Vazquez.

11 MEMBER VAZQUEZ: Good morning.

12 CHAIRPERSON COHEN: Good morning to you.

13 Good morning to you, Hasib Emran.

14 MR. EMRAN: Good morning.

15 CHAIRPERSON COHEN: All right. Let's gather down
16 and get started. This is the scheduled time for the
17 meeting of the Franchise Tax Board.

18 Would the Board Liaison please call the roll to
19 determine if a quorum is present.

20 MS. RUBALCAVA: Member Vazquez.

21 MEMBER VAZQUEZ: Present.

22 MS. RUBALCAVA: Deputy Member Gonzalez.

23 CHAIRPERSON COHEN: Deputy Member Gonzalez.

24 (No response.)

25 CHAIRPERSON COHEN: Not here.

1 Next.

2 MS. RUBALCAVA: And Chair-Controller Malia Cohen.

3 CHAIRPERSON COHEN: All right. Thank you.

4 Is there anyone online?

5 Is that you, Ms. Miller?

6 (No response.)

7 CHAIRPERSON COHEN: All right. Well, at least
8 two members or their designated representatives have
9 been personally present, there is a quorum, and the
10 Franchise Tax Board is now in session.

11 Please join me by rising and placing your right
12 hand over your heart and reciting the Pledge of
13 Allegiance.

14 (Pledge of Allegiance was recited in unison.)

15 CHAIRPERSON COHEN: All right. Thank you very
16 much.

17 Again I want to welcome everyone to our Board
18 meeting today. The public has a right to comment on
19 each agenda item. If there are any members of the
20 public wishing to speak on any item, please come forward
21 when the item is called, and you will have three minutes
22 to address the Board.

23 And for today's meeting, members of the public
24 who wish to comment via teleconference, please call
25 (877) 226-8189. And enter the access code of 6426797.

1 And please be aware that there is a short delay
2 between the Web and the live stream and the live event.

3 If there are any members of the public wishing to
4 speak on an item and you are using a translator or
5 translator services, you will have a total of six
6 minutes to address the Board. All speakers will be
7 asked to identify themselves for the record.

8 Okay. The first item, Members, is the approval
9 of the minutes. We have the minutes of the March 28th,
10 2023, Board meeting.

11 Members, do you have any comments or any
12 questions?

13 (No response.)

14 CHAIRPERSON COHEN: All right. Are there any
15 members of the public that would like to speak on this
16 item, either in person or on the -- on the line?

17 (No response.)

18 CHAIRPERSON COHEN: Okay. Seeing none --

19 PHONE MODERATOR: Members of the public on the
20 phone lines, if you would like to place yourself in
21 queue for public comment, as a reminder, please press 1,
22 then 0, at this time.

23 (No response.)

24 PHONE MODERATOR: No members of the public are
25 queuing up at this time.

1 Please continue.

2 CHAIRPERSON COHEN: All right. Thank you.

3 Do I have a motion for approval of the minutes?

4 MEMBER VAZQUEZ: So moved.

5 CHAIRPERSON COHEN: All right. Thank you. It's
6 been moved.

7 Is there a second?

8 Erica Gonzalez, are you on the line?

9 (No response.)

10 CHAIRPERSON COHEN: All right. Ms. Brunett.

11 CHIEF COUNSEL BRUNETT: Yes. I was just going to
12 say we're checking to see if she has technical
13 difficulties --

14 CHAIRPERSON COHEN: Sure.

15 CHIEF COUNSEL BRUNETT: -- but you can -- yeah --
16 proceed.

17 Thank you.

18 CHAIRPERSON COHEN: No problem. All right.

19 I will second that motion.

20 Mr. Vazquez, thank you very much.

21 Could you please call the roll?

22 MS. RUBALCAVA: Member Vazquez.

23 MEMBER VAZQUEZ: Aye.

24 MS. RUBALCAVA: Deputy Member Gonzalez.

25 (No response.)

1 MS. RUBALCAVA: Chair-Controller Malia Cohen.

2 CHAIRPERSON COHEN: Aye.

3 Thank you very much. This matter passes.

4 All right. Item 2 will be a video presentation
5 of FTB's 2022 awards. This is a staff report presented
6 by Ms. Jessica Clayton.

7 Good morning. The floor is yours.

8 MS. CLAYTON: Good morning, Madam Chair, and
9 Board Members. My name is Jessica Clayton. I am a
10 Section Manager in the Taxpayer Services Center Section
11 of the Franchise Tax Board.

12 Employee recognition is among the most rewarding
13 programs we facilitate within the Franchise Tax Board.
14 FTB understands the importance of recognizing those
15 employees who go above and beyond and deliver
16 exceptional products and services.

17 Regardless of what is happening around us, or the
18 new programs we administer, it is important that we
19 acknowledge, show appreciation, and celebrate those
20 employees who maintain a high level of service to our
21 department and the citizens of California.

22 While FTB has informal recognition programs
23 throughout the year, I am here to talk about four of our
24 formal Employee and Supervisor Recognition programs that
25 celebrate those who bring their best.

1 The Superior and Sustained Superior
2 Accomplishment Awards recognize individuals and teams
3 who make significant contributions to state government
4 through exceptional job performance.

5 The Supervisory Bonus Award recognizes
6 supervisors who demonstrate outstanding job performance
7 and leadership.

8 The Large Team Award recognizes the
9 accomplishments of large teams and project members and
10 their contributions to the Department's mission, goals,
11 and values.

12 In addition to contributing to the Department's
13 mission, goals, and values, the upcoming awards I will
14 be sharing with you support our Strategic Plan.

15 FTB's Strategic Plan presents our four goals and
16 affirms a set of principles that provide the foundation
17 of how we conduct business.

18 These principles support our mission and guide
19 our work as we achieve our goals and implement our
20 strategies to serve the State of California with
21 continued excellence.

22 The individuals and teams you will see through
23 the following slides have directly contributed to that
24 excellence. They showed up, participated, and led FTB
25 to great success.

1 These three award programs recognize specific
2 groups of FTB employees for their hard work, dedication,
3 and successful contributions of part of teams, large and
4 small.

5 Without further delay, please join me in
6 recognizing the recipients of the 2022 Superior,
7 Sustained Superior, Supervisory Bonus, and Large Team
8 Awards.

9 (Video presentation.)

10 MS. CLAYTON: This concludes our presentation
11 today. Thank you again for allowing us to share our
12 accomplishments.

13 At this time we will be happy to answer any
14 questions you may have.

15 CHAIRPERSON COHEN: Thank you very much.

16 Colleagues, do you have any questions? Any
17 comments that you wanted to acknowledge the recipients?

18 MEMBER VAZQUEZ: Just comments.

19 First of all, congratulations to all those that
20 receiving these commendations and recognition. And also
21 to thank you for your service.

22 I know, having worked in a government position
23 myself in the past, sometimes it's a very thankless job.
24 But to see that you are being recognized today, I think
25 it just shows the importance of it. But also to thank

1 your families. Because I know in many cases, especially
2 those that are heading up departments and are doing
3 above and beyond the call of duty, that means you are
4 taking away time from your families.

5 So I wanted to thank your families. And I know
6 many of them maybe are not here but hopefully are
7 listening.

8 And as I was looking, one of the things that just
9 caught my eye is it looked like maybe even close to 70
10 percent of the folks were women. So I guess the
11 males -- we need to step up here, but --

12 (Laughter.)

13 MEMBER VAZQUEZ: -- I have always said that the
14 women always do most of the work anyway but -- and it
15 shows here, because there -- I was looking at all the
16 photos that you were showing and the people that were
17 being recognized.

18 But once again, thank you for your service.

19 CHAIRPERSON COHEN: All right. Thank you very
20 much. Thank you for the wonderful slideshow. It's
21 nothing like -- there's no greater reward than to be
22 recognized by your peers that are people that are also
23 serving with you.

24 So it's my understanding that many of the award
25 recipients are either in the audience today or they are

1 online, listening. I just want to personally thank you
2 for your service and your commitment for being the
3 recipient of one of these very important awards.

4 And for those that are in the audience this
5 morning, could you stand up so we can just recognize
6 you. Please stand. Don't be shy. Come on. There you
7 go.

8 (Applause.)

9 CHAIRPERSON COHEN: Thank you very much.

10 I hope you all take the time to truly enjoy this
11 moment with your families and your loved ones and also
12 take a moment just to reflect on the journey that
13 brought you here.

14 And I want to just thank you for your service.
15 And this is a really important moment that we do, where
16 we celebrate and uplift leadership.

17 All right. Thank you.

18 We can go to the next item.

19 MS. BARTON: Good morning, Madam Chair, and Board
20 Members. My name is Jennifer Barton, Assistant Director
21 of the Financial Management Bureau.

22 I'm here today to present to you the fiscal year
23 '24-'25 budget concepts under development.

24 If appropriate, we will return to the September
25 Board meeting with fully developed proposals for your

1 approval. For the fiscal year '24-'25, we have
2 identified seven concepts for development.

3 CHAIRPERSON COHEN: Ms. Barton, please pardon me
4 for a second. I want to go back to the -- to Item 2
5 because we need to take public comment on it.

6 So what I would like to do is first just
7 recognize if there's anyone in the audience present that
8 would like to comment on maybe a friend, a family
9 member, or a fellow colleague's recognition, please step
10 right up to the microphones. Now is the appropriate
11 time.

12 (No response.)

13 CHAIRPERSON COHEN: Okay. And we'll also check
14 online for -- if there's anyone calling in for public
15 comment.

16 PHONE MODERATOR: Members of the public on the
17 phone lines, if you would like to place yourself in
18 queue for public comment, as a reminder, you may press
19 1, then 0, at this time.

20 (No response.)

21 PHONE MODERATOR: No members of the public are
22 queuing up at this time.

23 Please continue.

24 CHAIRPERSON COHEN: All right. Thank you very
25 much. Okay, Jessica.

1 MS. BARTON: Okay.

2 CHAIRPERSON COHEN: Thank you.

3 MS. BARTON: I will get started with Concept
4 Number 1.

5 CHAIRPERSON COHEN: Yes.

6 MS. BARTON: This is for the second phase of the
7 Enterprise Data Revenue --

8 CHAIRPERSON COHEN: Jennifer --

9 MS. BARTON: -- Project.

10 CHAIRPERSON COHEN: -- sorry.

11 MS. BARTON: That's okay. It starts with a J.
12 I'm good.

13 In 2008, the Franchise Tax Board began a
14 multiphase project to modernize our systems and achieve
15 a strategic target model. The EDR project's first phase
16 has successfully laid a foundation by delivering the
17 infrastructure and software architecture for our
18 consolidated platform with common business functions and
19 services.

20 The current phase, EDR2, builds on this platform
21 by delivering enterprise case management and modeling
22 services for audit, filing enforcement, and
23 underpayment, as well as expanding on the taxpayer
24 folder and Contact Center platform's functionality.
25 This concept will address the resources required for the

1 fourth year of planning, design, consulting, and
2 professional services that are critical to the success
3 of the EDR project.

4 The second concept is for the compliance and
5 revenue resources. This proposal requests funding and
6 positions to maintain Business Entity essential
7 compliance, and revenue-generating workloads. These
8 resources will allow FTB to maintain its required level
9 of access, meet revenue goals, avoid backlogs, and
10 optimize customer service experiences.

11 The third concept is for the political reform
12 audit resources. This proposal requests additional
13 resources and funding for working-level auditor
14 classifications needed to timely and effectively
15 complete mandated audits required by Section 90001 of
16 the Political Reform Act.

17 The fourth concept is for the mainframe storage
18 refresh. This proposal requests funding to replace
19 end-of-life mainframe hardware and software that stores
20 and backs up critical information for current business
21 processing and recovery during a disaster or ransomware
22 attack.

23 The fifth concept is for the disaster recovery
24 site network refresh. This proposal requests funding to
25 refresh IT network infrastructure components in FTB's

1 alternate storage site. The alternative storage site
2 allows FTB to continue providing critical services in
3 the event of a disaster impacting FTB's primary data
4 center.

5 The sixth concept is for campus security guards.
6 This proposal requests funding to procure security
7 guards for the Santa Ana Field Office and fund increased
8 costs for the Central Office security guards to obtain
9 qualified security for monitoring and protecting FTB's
10 vital infrastructure, work processes, and staff.

11 The final concept is for the customer callback
12 software refresh. This proposal requests funding to
13 replace end-of-life software that allows customers to
14 receive a callback instead of waiting on hold for
15 assistance.

16 The callback feature increases the level of
17 access, decreases repeat calls, avoids toll costs to
18 FTB, and improves customer service.

19 That concludes the presentation of all seven
20 concepts. Thank you, and happy to answer any questions
21 you may have.

22 CHAIRPERSON COHEN: All right. Thank you.
23 Colleagues, this is an informational item. Let's see.

24 Do you have any questions?

25 All right. Mr. Vazquez.

1 MEMBER VAZQUEZ: Just one quick one.

2 First of all, thank you for your presentation and
3 just the information that you presented here.

4 I just had a quick question in terms of the
5 political reform audits. And I'm aware FTB performs
6 these in order to evaluate an entity's recordkeeping and
7 disclosure for compliance with the Political Reform Act.

8 If you are permitted to disclose it,
9 approximately how many are performed each year?

10 MS. BARTON: That's a great question.

11 We conduct, on average, a hundred audits per
12 year.

13 MEMBER VAZQUEZ: And does that number
14 periodically -- I guess, does it increase periodically
15 or pretty much stay the same? Do we know?

16 MS. BARTON: It's an average. So it goes up and
17 down each year. And each of the workloads have
18 different cycles. Some are on two-year cycles. Some
19 are on four-year cycles. So we took a five-year
20 average. It's around a hundred.

21 MEMBER VAZQUEZ: Thank you.

22 CHAIRPERSON COHEN: All right. Thank you.

23 Let's go ahead and take public comment. If
24 there's any member of the public that would like to
25 comment on this item, please come up.

1 (No response.)

2 CHAIRPERSON COHEN: All right. Seeing none,
3 let's take public comment online.

4 PHONE MODERATOR: Members of the public on the
5 phone lines, if you would like to place yourself in
6 queue for public comment, as a reminder, you may press
7 1, then 0, at this time.

8 (No response.)

9 CHAIRPERSON COHEN: Okay. Seeing none. Thank
10 you very much.

11 I believe we have a presentation by Mr. Banuelos;
12 is that correct?

13 Good morning, Michael.

14 MR. BANUELOS: Good morning, Madam Chair, and
15 Board Members.

16 Madam Chair, I don't -- I don't know, do we want
17 to do a sound check? I see Ms. Gonzalez is on here,
18 and --

19 CHAIRPERSON COHEN: Oh, okay.

20 MR. BANUELOS: -- I don't know whether she can
21 hear us or not.

22 CHAIRPERSON COHEN: Ms. Gonzalez, are you online?

23 (No response.)

24 CHAIRPERSON COHEN: She can hear us, but we can't
25 hear her.

1 MR. BANUELOS: Okay.

2 CHAIRPERSON COHEN: Okay. Thank you.

3 MR. BANUELOS: Sure. I will go ahead and
4 proceed.

5 CHAIRPERSON COHEN: We'll keep trying.

6 MR. BANUELOS: Okay. My name is Michael
7 Banuelos, and I'm the director of the Franchise Tax
8 Board's Procurement Bureau. I'm here today to present
9 one Facilities Action Item for your approval.

10 This request pertains to our Van Nuys field
11 office. Our existing lease at the Van Nuys field
12 facility is set to expire on June 30th of 2023.

13 Unfortunately, the Department of General Services
14 recently informed us that the lessor will not grant a
15 long-term extension to our lease in that facility.

16 DGS is working on a short-term extension in that
17 facility that should get us through January 31st of
18 2024, but we will need to submit a request to DGS to
19 start looking for a new facility so that we can enter
20 into a new lease.

21 Our Van Nuys field office, which is not a public
22 service office, houses 53 Audit Division staff in
23 approximately 8,800 square feet.

24 At this time I'm requesting your approval to
25 submit this request to DGS, and we would be happy to

1 answer any questions you may have.

2 CHAIRPERSON COHEN: Thank you.

3 Let me check with my resident Southern
4 Californian.

5 Any comments?

6 MEMBER VAZQUEZ: Yes. Having worked with DGS, I
7 think you need to move on it as quick as you can because
8 they are relatively pretty slow. I've been going
9 through this just in my own office trying to move --
10 relocate my office space.

11 But having said that, I know -- if you are
12 looking at Van Nuys, I know you are currently in a --
13 I'm assuming it's a private -- it's not a State
14 facility. They do have a State building, which they
15 technically call the City Hall of Van Nuys or San
16 Fernando Valley. I don't know if you have looked at it,
17 but I know currently there's -- there should be offices
18 available there.

19 I don't know how much space you need, but they
20 have, like, I know, reps from the Assembly and the City
21 Council and the Senate office for that area currently in
22 that State building. So you might want to take a look
23 at that. Because I know you are looking at this
24 expiration right around the corner, and that might help
25 expedite it for you.

1 The other issue I was just wondering, in this
2 transition, I know you mentioned that this is not a
3 facility that you allow people to just walk in. It's
4 more of just for audits. It's more for staffing, for
5 them to do their work.

6 But I was wondering, in the transition, what --
7 what is the plan to make sure that there isn't any
8 downtime? Because I know that is probably going to set
9 back a lot of your work -- your auditors.

10 MR. BANUELOS: So yeah. Our Audit Division is
11 working with Facilities right now to come up with some
12 mitigation plans. So, you know, obviously, the -- since
13 it's not a public counter, the impact likely is going to
14 be more to our employees.

15 So they are looking at some options. Hopefully
16 everything is in order and we have a new facility by the
17 end of January. But they are looking at other options
18 such as the ability, at least temporarily, to do more
19 teleworking.

20 Or perhaps, if they have to have meetings or they
21 need a physical space, we could look and see if the
22 option is there where they can meet in the West Covina
23 office or the West Los Angeles office. So they are
24 coming up with mitigation plans.

25 MEMBER VAZQUEZ: Okay.

1 CHAIRPERSON COHEN: All right. No other
2 questions?

3 MEMBER VAZQUEZ: I'm good.

4 CHAIRPERSON COHEN: All right. Thank you very
5 much. I have no other questions either.

6 Let's go ahead and take public comment on this.

7 MEMBER GONZALEZ: Can you hear me?

8 CHAIRPERSON COHEN: Yes.

9 MEMBER GONZALEZ: Oh, great. I'm so sorry, Madam
10 Chair. Erica Gonzalez, Department of Finance.

11 CHAIRPERSON COHEN: No problem.

12 Do you have any questions, Member Gonzalez, or
13 any statements that you would like to make on Item 3?

14 MEMBER GONZALEZ: No. Thank you.

15 CHAIRPERSON COHEN: Okay. No problem. Thank
16 you.

17 Let's go ahead and see if there's any public
18 comment in the -- in the chamber.

19 Is there any comment?

20 (No response.)

21 CHAIRPERSON COHEN: No? Okay. We'll go online.

22 PHONE MODERATOR: Members of the public on the
23 phone lines, if you would like to place yourself in the
24 queue for public comment, as a reminder, you may press
25 1, then 0, at this time.

1 (No response.)

2 PHONE MODERATOR: No members of the public are
3 queuing up at this time.

4 Please continue.

5 CHAIRPERSON COHEN: All right. Thank you very
6 much.

7 I will make a motion to approve the submission of
8 the CRUISE request for DGS to begin looking for new
9 office space within the Van Nuys or the surrounding area
10 and, of course, to perform any necessary tenant
11 improvements. That's my motion.

12 Is there a second?

13 MEMBER VAZQUEZ: Second.

14 CHAIRPERSON COHEN: All right. Thank you. So a
15 motion has been made by myself, seconded by Mr. Vazquez.

16 Let's call the roll.

17 MS. RUBALCAVA: Member Vazquez.

18 MEMBER VAZQUEZ: Aye.

19 MS. RUBALCAVA: Deputy Member Gonzalez.

20 MEMBER GONZALEZ: Aye.

21 MS. RUBALCAVA: Chair-Controller Malia Cohen.

22 CHAIRPERSON COHEN: Aye.

23 Thank you. Fantastic. Thank you, Mr. Banuelos.

24 MR. BANUELOS: Thank you.

25 CHAIRPERSON COHEN: Item 4 is on the Executive

1 Officer's time.

2 And I will turn it over to you. Thank you.

3 EXECUTIVE OFFICER STANISLAUS: Thank you. Thank
4 you, Madam Chair; and good morning, Board Members.

5 For my time today I will provide updates for this
6 filing season and the Middle Class Tax Refund Program.

7 I will begin by sharing a few highlights that
8 show the status of our 2023 filing season.

9 We made several important improvements that are
10 assisting taxpayers this year. First we implemented the
11 legislative changes for the Foster Youth Tax Credit and
12 the expansion of the Young Child Tax Credit eligibility.

13 Second, our VITA Teams and volunteers attended
14 over 20 community events and served over 875 customers
15 by preparing over 970 returns.

16 And lastly we expanded the number of notices
17 eligible for paperless delivery through MyFTB account.

18 And for our tax professionals, too, we began
19 offering a virtual hold callback function on our Tax
20 Practitioner's Hotline, and we are seeing improvements
21 in their wait time.

22 So as mentioned at the March meeting, the
23 taxpayers and businesses in most counties in California
24 can postpone the filing of their 2022 tax returns and
25 payments to October 16, 2023.

1 Even with this extension in place, as of right
2 now, we have processed 16.6 million personal income tax
3 returns, with 93.3 percent of those e-filed.

4 12.6 million refunds, with an average refund of
5 \$1400. And about 90 percent of the refunds were issued
6 in under ten days.

7 Better still, 10.3 million refunds were deposited
8 directly in the taxpayer's bank account. And 7.4 tax
9 payments, totaling 37 billion, with 81 percent of the
10 money was received electronically.

11 So now let me share an update on the Middle Class
12 Tax Refund.

13 I'm happy to share that our partners from the
14 State Controller's Office, the State Treasurer's Office,
15 and Money Network, we successfully delivered
16 16.8 million payment to taxpayers at a value of
17 \$9.2 billion.

18 7.2 million of these payments were delivered
19 directly to taxpayers' bank accounts, while 9.6 million
20 payments were delivered to taxpayers by debit card.

21 So as of end of May, 86 percent of these cards
22 have been activated by taxpayers, with more than
23 37 percent of these cards have been fully used.

24 So for those taxpayers that have not yet
25 activated their debit cards, FTB and Money Network sent

1 reminder letters to each individual reminding them of
2 the value of the MCTR Program and how to activate their
3 cards.

4 So in closing, I want to once again express my
5 gratitude to our Board Members who always provide
6 valuable perspective and feedback. With your support,
7 we look forward to completing another successful filing
8 season.

9 Thank you, Board Members, for your time.

10 CHAIRPERSON COHEN: Thank you. I actually have a
11 question.

12 I know in the recent past years, we have been
13 making a concerted effort to encourage filers to file
14 via e-file --

15 EXECUTIVE OFFICER STANISLAUS: E-file.

16 CHAIRPERSON COHEN: -- to become an e-filer.

17 And I notice that we are almost at a hundred
18 percent. This year we're coming in at 93.3 percent.

19 What's the percent increase from last year? Do
20 you happen to know that number?

21 EXECUTIVE OFFICER STANISLAUS: Do we know that
22 number, Roger?

23 MR. LACKEY: It's -- at this point in time, it's
24 between 1 and 2 percent.

25 EXECUTIVE OFFICER STANISLAUS: Yes. It's between

1 1 and 2 percent at this point in time, but we'll have
2 the numbers October 16th.

3 CHAIRPERSON COHEN: October 16th, we'll have the
4 final numbers. Okay.

5 It's so impressive. 7.4 million tax payments
6 totaling \$37 billion. That's absolutely incredible.
7 With 81 percent of the money received electronically,
8 streamlining the process.

9 And I would imagine, when we're dealing with the
10 electronic mechanisms for transferring of information
11 and payments, that it eliminates human error? Is that
12 right? And is there some cost cutting as well that
13 happens in terms of saving on paper, human power -- I
14 don't want to say, "manpower," but human power?

15 EXECUTIVE OFFICER STANISLAUS: Yes.

16 CHAIRPERSON COHEN: All right. Well, thank you
17 very much.

18 Do you have any questions or comments you would
19 like to make?

20 MEMBER VAZQUEZ: Mine is more of a comment, Madam
21 Chair.

22 CHAIRPERSON COHEN: All right. Please.

23 MEMBER VAZQUEZ: Well, first of all, just thank
24 you for your presentation, Selvi. I look forward to
25 hearing, though, the updates in the coming -- in the

1 fall, that I guess we will have the final numbers that
2 we're looking at, and just seeing if the postponement to
3 the Middle Class Tax Refund helped people file their
4 returns on time.

5 I'm also eager to see if the extensions affected
6 the budget forecasting to the -- to fund these County
7 and local governments coming up in '24-'25. So I guess
8 I will wait to hear that.

9 Thanks.

10 CHAIRPERSON COHEN: Thank you. All right. So
11 there's more to come.

12 Let me just pivot to my colleague online.

13 Gonzalez, Member, do you have any questions or
14 comments that you would like to make on these numbers?

15 MEMBER GONZALEZ: No, thank you, Madam Chair.

16 CHAIRPERSON COHEN: All right. Thank you.

17 Thank you, Ms. Stanislaus. I appreciate your
18 comments.

19 Let's go to public comment and hear what the
20 public has to say.

21 If there's anyone in the chamber that would like
22 to speak?

23 (No response.)

24 CHAIRPERSON COHEN: All right. Seeing none,
25 let's go to those that are online.

1 PHONE MODERATOR: Members of the public on the
2 phone lines, if you would like to place yourself in
3 queue for public comment, as a reminder, you may press
4 1, then 0, at this time.

5 (No response.)

6 PHONE MODERATOR: No members of the public are
7 queuing up at this time.

8 Please continue.

9 CHAIRPERSON COHEN: All right. Thank you.

10 That brings us to Item 5, Board Members' time. I
11 would -- let's check with the Chair of the Board of
12 Equalization, Mr. Vazquez, to see if he has any
13 comments.

14 MEMBER VAZQUEZ: Yes.

15 CHAIRPERSON COHEN: Please.

16 MEMBER VAZQUEZ: Thank you, Madam Chair.

17 Just a comment and a question. And just I wanted
18 to bring to the record, I guess, that I'm interested in
19 bringing back this Mobile Volunteer Unit that we had
20 talked about. And I know, in my conversations with
21 Selvi, she's really working real hard because I'm
22 assuming, during COVID, that, you know, it was just
23 sitting there. So it's no longer available.

24 But I'm just putting it out there again, hoping
25 that this will come back. I'm not sure in what format.

1 But just interested. Because having gone to a couple of
2 these in the past and even some of the resource fairs
3 I've participated even during COVID and after COVID with
4 my County Assessor, they are so valuable for folks,
5 especially for those that don't have the resources or
6 the -- really the know-how, how to navigate the system,
7 to make sure they are getting the most and hopefully the
8 best advice as they are filing their taxes as well.

9 And I guess -- and then I would move into more of
10 a question on the VITA legislation. I understand
11 there's some VITA legislation out there.

12 First of all, just thanking you for sending me
13 the list of all the bills that are being proposed and
14 augmented to expand and assist the VITA program. It
15 appears that there are seven to eight of them at various
16 stages right now in the game.

17 Does it look like any of them, even perhaps SB
18 220, now at the Budget Committee, may be successful?

19 MR. HOFELING: Yes, Member.

20 So, as you know, as you have just said, that 220
21 is now a budget bill, and so we continue to watch that
22 at that point, and so we kind of watch our partners in
23 the Assembly and the Legislature to see the success of
24 that bill.

25 MEMBER VAZQUEZ: And then I notice there's

1 another one with Senate Bill, I guess it's 565, with
2 Ms. Caballero, would require FTB to provide a free
3 online tax return preparation protocol, the CalFile, to
4 qualify individuals, that is individuals who would
5 qualify for Cal, I guess it's EITC, for taxable years on
6 and after January 1 of 2025.

7 How would this bill expand the online services
8 the FTB currently provides, and how many lower-income
9 people do you think it would be able to assist relative
10 to the cost?

11 MR. HOFELING: So we have our Legislative
12 Director, Denis Armstrong, here, and he can answer that
13 question for you.

14 MR. ARMSTRONG: Thank you, Shane.

15 And thank you for your question, Board Member
16 Vazquez.

17 So for SB 565, that is a program that will
18 provide enhanced CalFile option, which will allow for
19 prepopulated data to be provided to potential taxpayers
20 to claim the EITC credits.

21 The -- we have done some -- it -- first off, it's
22 a little difficult to truly anticipate taxpayer behavior
23 based on certain products that are available.

24 In our published analysis -- and I would be happy
25 to provide a copy for you at the end of this -- we have

1 looked at potentially, for the first year, for the 2025
2 tax year, about 140,000 taxpayers will be impacted by
3 this.

4 For the '26 tax year, 420,000.

5 And then for the '27 tax year, 549,000.

6 MEMBER VAZQUEZ: And I thank you. I appreciate
7 it.

8 And I guess, along those lines, has FTB taken a
9 position on SB 565? Do you know?

10 MR. HOFELING: No. FTB traditionally doesn't
11 take a position on any bill unless the three-member
12 Board, your Board, chooses to take an official position.
13 Otherwise, we remain neutral on all bills. The only
14 exception is if it is a bill that -- or was a
15 legislative proposal that was approved by your Board.

16 MEMBER VAZQUEZ: So then I guess I have two
17 follow-ups. So one would be -- and it sounds like, in
18 the analysis, I guess that you had mentioned, does
19 that -- is that favorable to SB 565?

20 MR. ARMSTRONG: When you say -- when you say,
21 "favorable," so our analysis would be from a technical
22 perspective.

23 MEMBER VAZQUEZ: It wouldn't be whether you
24 support or --

25 MR. ARMSTRONG: Correct.

1 As Mr. Hofeling mentioned, we --

2 MEMBER VAZQUEZ: Okay.

3 MR. ARMSTRONG: -- would only support anything
4 approved by the Board.

5 MEMBER VAZQUEZ: So then I guess my follow-up
6 question: Would it be helpful if we, as the Board -- or
7 are we allowed to, as a Board, and I'm asking, I guess,
8 our Chair to take a position if we think it's something
9 that would be helpful? Because it's -- I'm listening to
10 it. I haven't seen the analysis that you have put
11 together.

12 But at least in listening to the comments and in
13 reading at least what I have picked up from the Senator
14 on this bill, that it could be advantageous for
15 low-income folks.

16 CHAIRPERSON COHEN: Well, I look to the legal
17 opinion.

18 I'm comfortable with taking a position and
19 supporting the legislation or taking -- following your
20 recommendation. But I don't think that that is the
21 standard practice of the FTB. I don't believe you
22 actually take positions.

23 You're -- you stand in more of a neutral
24 territory, right?

25 So we are more enforcing the laws than

1 necessarily opining or our opinion in -- or, in this
2 case, blessing.

3 Does that sound right?

4 MR. HOFELING: Yes.

5 CHAIRPERSON COHEN: Okay. So I don't think we
6 will be taking any action.

7 MEMBER VAZQUEZ: That's why I was just asking
8 is -- I know you, as -- because you are more on the
9 administrative side, or on the bureaucratic side,
10 whereas the elected side, I didn't know if that was
11 something --

12 CHAIRPERSON COHEN: We're acting as a full body,
13 and I don't think we should do it.

14 MEMBER VAZQUEZ: Okay. Just putting it out
15 there.

16 CHAIRPERSON COHEN: I appreciate it.

17 MEMBER VAZQUEZ: Thank you.

18 CHAIRPERSON COHEN: Ms. Stanislaus, you looked
19 like you were -- wanted to say something.

20 EXECUTIVE OFFICER STANISLAUS: No.

21 CHAIRPERSON COHEN: No? Okay.

22 EXECUTIVE OFFICER STANISLAUS: So that is
23 correct.

24 But Board Member Vazquez, you are free to, you
25 know, send your left of support individually of course.

1 MEMBER VAZQUEZ: Not a problem. Thank you.

2 CHAIRPERSON COHEN: Thank you very much.

3 All right. Thank you.

4 So if there's -- there's three things that I want
5 to acknowledge in my brief remarks. Thank you for your
6 answering the questions.

7 First, I just want to recognize that here we are
8 in the last week of June, and we celebrated Juneteenth
9 earlier this month, and want to acknowledge the
10 celebration, the magnitude of that, that national
11 holiday.

12 And also, I want to recognize Pride. We just --
13 June is also Pride month, recognizing the life
14 achievements and the struggle, quite honestly, of the
15 LGBTQ+ movement. Both -- both the LGBTQ movement and
16 the African American community still continue to strive
17 and break barriers and transcend systems that look to
18 oppress them and hold them down.

19 So I wanted to just give some voice to that
20 today, as we round out June.

21 And the final thing that I would like to share
22 with you is I would like to introduce you to a new
23 member of my staff, Ms. Windie Scott, who is sitting up
24 here in the front.

25 If you could just stand up and wave just so

1 people can see who you are.

2 Windie Scott is a retired annuitant. She's
3 coming on board to just provide advice and counsel.
4 She's has a long, distinguished career, not only with
5 the Board of Equalization, but also here at the
6 Franchise Tax Board.

7 I think, Ms. Stanislaus, you might be very
8 familiar with her tenure; is that correct?

9 EXECUTIVE OFFICER STANISLAUS: Yes, I am. I
10 worked for her and worked with her.

11 CHAIRPERSON COHEN: Oh, okay. I know. I don't
12 know; I seem to bring people on to my team that I also
13 worked for.

14 So, Ms. Scott, thank you very much. I appreciate
15 you for being here.

16 And, of course, just as a way of introduction,
17 this is Hasib Emran, who is also my Deputy of Taxation,
18 has been with our team for quite some time now.

19 So that brings us to a unique moment in the
20 agenda, where we have scheduled a ten-minute short
21 recess at this time.

22 Unless there are any objections, we will go into
23 a ten-minute recess and then -- and before we go into
24 our ten-minute recess, we will take public comment.

25 Thank you for the reminder.

1 Any member of the public that's in the chambers
2 today that would like to comment on any items today?

3 (No response.)

4 CHAIRPERSON COHEN: None? Okay.

5 We will go to public comment online.

6 PHONE MODERATOR: Members of the public on the
7 phone lines, if you would like to place yourself in
8 queue for public comment, as a reminder, you may press
9 1, then 0, at this time.

10 (No response.)

11 PHONE MODERATOR: No members of the public are
12 queuing up at this time.

13 Please continue.

14 CHAIRPERSON COHEN: All right. Thank you very
15 much. Ladies and gentlemen, we will reconvene at
16 11:40 a.m. Thank you.

17 (Break taken in proceedings:

18 11:28 a.m. to 11:45 a.m.)

19 CHAIRPERSON COHEN: Good morning, ladies and
20 gentlemen. I would like to call the Franchise Tax Board
21 meeting back into order.

22 Thank you.

23 Do we have Member Gonzalez with us online?

24 (No response.)

25 CHAIRPERSON COHEN: I will trust that she's on.

1 EXECUTIVE OFFICER STANISLAUS: Yes, we do.

2 CHAIRPERSON COHEN: Thank you.

3 All right. This meeting will now come back to
4 order. We have got Agenda Item Number 6, Section 25137
5 petition hearing by Daimler North American Corporation
6 and Subsidiaries.

7 You -- appearing on behalf of the Petitioners is
8 Daimler North American Corporation and Subsidiaries --
9 is counsel Mr. Jon Sperring.

10 Mr. Sperring, where are you? Good to see you
11 this morning.

12 And on -- and appearing on behalf of the
13 Franchise Tax Board staff will be Irina Iskander
14 Krasavtseva.

15 Thank you. I just got a thumbs-up for that one.

16 And also joining the team is Delinda Tamagni,
17 also joining.

18 I got a double thumbs-up. All right. We're off
19 to a great start.

20 So let me just give you the format of what you
21 can expect for this hearing this morning. The
22 Petitioners will have 30 minutes to make their
23 presentation, and the Franchise Tax Board staff will
24 have 30 minutes to reply. Then the Petitioners will
25 have an additional 15 minutes for rebuttal.

1 Counsel, you may proceed.

2 MR. WHITNEY: Thank you, Madam Chair and
3 Honorable Members of the Board.

4 My name is Chris Whitney, and with me is Jon
5 Sperring. We're both partners with PwC, and we both
6 thank you for your time today.

7 We are here on behalf of our client, Daimler, to
8 request an adjustment to the standard apportionment
9 formula, because the standard formula, as we'll
10 demonstrate, doesn't fairly reflect our activity in
11 California.

12 As we will demonstrate, in order for Daimler to
13 lease a vehicle to California consumers, it must first
14 sell the vehicle to California dealers. That then
15 necessitates buying the vehicle back from the dealers,
16 resulting in no economic profit to Daimler.

17 Now, even though the sale is undone and there's
18 no economic profit, the standard apportionment formula
19 includes that sale in the sales factor in addition to
20 the leasing receipts on the very same vehicle that will
21 be received.

22 And so this double counting produces an unfair
23 result because the leasing activity in California occurs
24 disproportionately relative to the sale of vehicles
25 outside the state.

1 Fortunately, there's a very simple solution.
2 Your Board may grant an adjustment to the standard
3 apportionment formula to simply exclude the
4 double-counted unwound sales that don't produce any
5 economic profit. Doing this will leave the leasing
6 receipts that produce the profit in the apportionment
7 formula. It will have no effect on taxable income. It
8 will be fair, reasonable, and fully consistent with
9 adjustments that the FTB staff has made for decades to
10 the standard formula.

11 So in thinking about apportionment, basically
12 it's the process by which you take total income and
13 attribute a fair share of that to Californians so a fair
14 amount of tax can be imposed.

15 The formula itself is simplicity. It's
16 California sales over everywhere sales is your
17 apportionment percentage. Now, how you apply that is
18 you apply it to total income which, for me, I like to
19 think as -- you know, basically like a pie. You have
20 got gross income that goes into the pie as well as
21 deductions. That kind of determines, you know, the
22 shape and the size of the pie.

23 We're not here to discuss that because the IRS
24 and FTB Audit Staff have already reviewed total income,
25 and they have confirmed that amount.

1 We're here really to look at the middle, which is
2 the apportionment formula, and to look at fair
3 apportionment of the overall income.

4 Essentially it's sort of determining the slice of
5 the pie that California gets to the tax.

6 Now, sometimes the standard apportionment formula
7 doesn't fairly reflect your activity in the state. And
8 when that happens, either the FTB may require or a
9 taxpayer may petition for an adjustment to the formula,
10 like we're doing today.

11 And Daimler's facts, as you can see on the far
12 right, are very extreme. Some 36 to 44 percent of our
13 California sales are no more than these undone sales to
14 California dealers, that are repurchased, producing zero
15 economic profit. As compared to other cases that --
16 over the decades, the FTB has required similar
17 adjustments to remove those kinds of sales.

18 You have got examples here of PacTel and
19 Microsoft, which were the Treasury receipts cases.
20 There are many others. In this situation there was a
21 single pool of cash. That cash would be used to buy
22 investments. Those investments would be sold, bringing
23 cash back. You would then use the cash to buy more
24 investments and sell them again.

25 The basic investment pool, that cash, was being

1 double counted, over and over and over again, really
2 producing very little or no economic profit along the
3 way. And the FTB pointed to that and said that this
4 out-of-state activity was inflating the sales factor
5 denominator. It was double counting results. It didn't
6 produce any income. And it should be removed from the
7 formula.

8 The General Mills situation is very similar.
9 There were hedging transactions on either side of the
10 commodity price. They offset each other. They were
11 sort of double counted, if you will, and they didn't
12 produce any economic profit to speak of. Sometimes a
13 lot; sometimes a little bit of income.

14 Our situation is very similar to these
15 situations, just in the reverse. Instead of
16 out-of-state activity, this is activity that
17 predominantly occurs within California, but it's the
18 same basic problem. And the same basic problem really
19 calls for a fair and consistent solution, which is to
20 remove the double-counted receipts that don't produce
21 any economic profit.

22 Now, this is the way the standard apportionment
23 formula should and most often does work. If you sell 10
24 percent of your product in California, as you would
25 expect, you would have a 10 percent apportionment

1 factor. You would apply that to your income and pay tax
2 on 10 percent of your taxable income. That would be
3 logical, it would be consistent with what you would
4 expect.

5 However, when you have a auto manufacturer with a
6 leasing subsidiary, that is where things go awry.
7 Because, again, you are double counting under the
8 standard apportionment formula the leasing activity.
9 That sale to the dealer that is purchased back with no
10 economic profit is still in the standard formula in
11 addition to the leasing receipts.

12 So if you do that kind of activity in California,
13 and in this example if you are doing sales of cars and
14 vehicles outside of the state, it doubles the numerator
15 without having a similar effect on the denominator. And
16 so you wind up going from 10 to 18 percent
17 apportionment.

18 You know, really, you are still just selling
19 10 percent of your cars in California, but now we have
20 18 percent of our income being attributed to California
21 in tax.

22 We don't believe that's fair. We think that
23 there's a very easy and simple solution to it.

24 I'm going to turn it over to my partner, Jon, who
25 is going to talk about Daimler's specific facts in

1 greater detail and also the remedy.

2 MR. SPERRING: Thank you, Chris.

3 Good morning, Madam Chair, and Honorable Board
4 Members.

5 Slide 11 provides an outline of the steps of a
6 lease transaction financed by Daimler.

7 As required by California law, Daimler sells
8 vehicles to third-party, independent, authorized
9 dealerships. Consumers go to the dealerships to buy or
10 lease new vehicles. If the consumer elects to lease a
11 vehicle through Daimler, as opposed to a third-party
12 bank, Daimler's leasing affiliate will buy the leased
13 vehicle back from the dealership to facilitate the lease
14 of the vehicle to the end consumer.

15 Daimler's leasing affiliate collects all lease
16 payments as well as receipts from the ultimate sale of
17 the vehicle after the lease.

18 Slide 12 illustrates the treatment of Daimler's
19 lease transactions in the standard apportionment
20 formula. You will see that the result is a double
21 counting of total receipts for every vehicle that is
22 leased by Daimler. This is because the receipts from
23 the undone sale to the dealer, the lease payments, and
24 the final sale of the car after the lease are all
25 included in the sales factor, capturing the value of the

1 vehicle twice.

2 Slide 13 provides an illustration of why the
3 doubling up of leased vehicle receipts is occurring. In
4 this simplified example, a car is sold to the dealer for
5 50K, and the lease payments and the residual sale also
6 equal 50K.

7 Note that the unwound vehicle sale, pursuant to
8 the lease transaction, is not removed from the gross
9 receipt, as a return of goods sold. But instead, is
10 included in the sales factor.

11 Including the receipts from the undone sale
12 results in 100K in the sales factor in this example,
13 instead of 50-, if the same vehicle had been purchased.

14 The standard apportionment formula fails to treat
15 the undone sale as a return of goods sold because the
16 affiliated leasing company that purchased the vehicle
17 back from the dealer is a separate legal entity from the
18 manufacturing company that originally sold the car to
19 the dealer, even though both entities have the same
20 ultimate parent company, Daimler North America and
21 Subsidiaries. And are part of the same unitary
22 business.

23 Failure to treat the unwound sale as a single
24 return transaction conflicts with unitary taxation and
25 leads to double counting in the apportionment of leased

1 vehicles.

2 Looking at the entire unitary business as opposed
3 to discrete subsidiaries within a corporate enterprise
4 is the linchpin of "apportionability," as the U.S.
5 Supreme Court so eloquently stated in Mobil Oil.

6 In this case the standard formula fails to
7 disregard the legal entities and instead artily
8 treats -- or artificially treats what is economically a
9 returned purchase by one unitary business as two
10 separate and distinct transactions.

11 Treating the sale as a -- as separate from the
12 repurchase creates an artificial revenue stream that
13 generates zero economic profit. This artificial revenue
14 stream distorts Daimler's sales factor.

15 The good news is the drafters of California's
16 apportionment formula realize that the standard formula
17 will not always reflect the taxpayer's market, and,
18 therefore, included a provision allowing for alternative
19 method of apportionment.

20 Use of an alternative formula is appropriate in
21 Daimler's case because leased vehicles at a higher rate
22 in California. Mercedes-Benz are frequently leased,
23 while Daimler's trucks and buses are seldom leased and
24 are sold to a much lesser extent in California.

25 By double counting leasing activities that is

1 heavily weighted to California, while counting
2 out-of-state truck and bus sales only once, the standard
3 formula apportionment fails to reflect Daimler's
4 California activities.

5 Slide 14 addresses Daimler's proposed remedy to
6 cure the double counting of leased vehicles. Daimler's
7 requested remedy is simple: Remove the unwound sales to
8 the dealerships that generate zero economic profit from
9 the apportionment formula. This is the same remedy that
10 FTB requested, and the Courts granted, in Pacific
11 Telephone and Telegraph, Microsoft, and the General
12 Mills cases.

13 Moreover, it does not impact Daimler's income.
14 Also, it is the only method that fairly reflects the
15 portion of Daimler's income derived from California.

16 I respectfully conclude our remarks and reserve
17 any remaining time for taxpayer's rebuttal.

18 CHAIRPERSON COHEN: Thank you very much.

19 MS. KRASAVTSEVA: Good morning, Chair Cohen, and
20 Members of the Board.

21 My name is Irina Iskander Krasavtseva. And to
22 simplify communication a bit, I will go by Irina
23 Iskander. I'm a Tax Counsel IV at the Multistate Tax
24 Bureau in the FTB's Legal Division. With me is my
25 Assistant Chief Counsel, Delinda Tamagni.

1 Over the next 30 minutes, we will briefly cover
2 applicable legal framework and illustrate how it applies
3 to the taxpayer's situation in this case.

4 Throughout this presentation, you will often hear
5 terms like "apportionable income," "apportionment
6 factor," and "factor representation."

7 It is often easier to think of Taxpayer's total
8 apportionable business income in terms of a pie or a
9 total income pie and of the apportionment as a method of
10 determining California's slice of the pie.

11 During this presentation, we will also discuss
12 Taxpayer's relevant business activities and extent of
13 these activities in California. We then will show why
14 the standard formula that factor represents Taxpayer's
15 distinct business activities that proportionally
16 contribute to Taxpayer's apportionable business income,
17 the pie, do not amount to double counting.

18 The standard apportionment formula is fair
19 because in this case it relies on fair factor
20 representation of each relevant and distinct business
21 activity.

22 As Taxpayer did not carry its burden of proving
23 otherwise, it is not entitled to the \$38 million in
24 refunds it is seeking pursuant to its Section 25137
25 Petition.

1 Let's talk about apportionment.

2 First, apportionment is not about determining
3 apportionable business income. Apportionment is a
4 method of assigning a portion of that pie to various
5 states where Taxpayer's business activities take place.
6 It is a mathematical equation that determines a slice of
7 a Taxpayer's total business income pie that a state gets
8 to tax.

9 For this reason, a proper argument for or against
10 validity of the apportionment formula that determines
11 that slice of the pie must discuss whether the formula
12 fairly reflects Taxpayer's business activities which
13 generate the pie.

14 Does the formula reflect the very activities --
15 not more, not less -- that generate the Taxpayer's
16 revenue and expenses used to make up its total
17 apportionable income pie?

18 Fair apportionment is about fair factor
19 representation.

20 Now, when it comes to devising an apportionment
21 formula, states are permitted to tax an apportionable
22 share or the slice of the multistate business partially
23 carried on in the taxing state.

24 And states also have wide latitude to fashion a
25 formula used to -- for approximating the in-state

1 portion or the slice of the total volume that the
2 business enterprise produces through its multistate
3 business activities.

4 The standard formula in this case is the single
5 sales factor apportionment formula, which is a fraction
6 of Taxpayer's gross receipts over its gross receipts
7 from its regular trade or business conducts everywhere.

8 In this particular case, Taxpayer's everywhere
9 sales are its U.S. sales only.

10 Note that when it comes to each activity that
11 contributes to composition of the Apportionable Business
12 Income, the same activities are also factor represented
13 in the sales factor by their respective gross receipts.

14 For example, if Taxpayer here simply manufactured
15 and sold cars to unaffiliated dealers, its apportionable
16 income -- represented here as a green circle -- would
17 be -- will be calculated by reference to income from
18 sales of cars less attributable business expenses,
19 including the costs of the cars sold.

20 Once we know how much apportionable income
21 Taxpayer generated during the tax year at issue, we next
22 think about how to determine California's portion of the
23 total income pie.

24 We do that by a formula, which in our simple
25 example, factors in gross receipts from selling cars in

1 California versus everywhere. If Taxpayer sold 100 cars
2 in total for \$100 each, and 20 of those cars were sold
3 in California, we would assign 20 percent of Taxpayer's
4 total apportionable income to California.

5 We arrive at that 20 percent by dividing \$2,000
6 in gross receipts, realized in California, over the
7 \$10,000 in gross receipts realized in overall sales of
8 cars. In this slide, the slice of the pie represents
9 the 20 percent.

10 As you can see from this slide, the pie is
11 composed of the revenue and expenses attributable to the
12 car sales, while the slice factors in or is determined
13 by reference to the gross receipts from the very same
14 car sales.

15 This last concept is usually referred to as
16 "factor representation."

17 There are situations, however, where the
18 application of the standard rules result in unfair
19 representation of Taxpayer's business activities.

20 In those situations, Section 25137 of California
21 Tax Code allows for deviation from the standard rules by
22 either FTB or Taxpayer when application of such rules
23 results in unfair representation of the extent of the
24 taxpayer's business activity in this state.

25 These rules also require that a party invoking

1 Section 25137 carries the burden of proving, by clear
2 and convincing evidence, first, that the approximation
3 provided by the standard formula is not a fair
4 representation; and, second, that the party's proposed
5 alternative is reasonable.

6 For example, in the Microsoft case, California
7 Supreme Court viewed Microsoft's operation of its large
8 Treasury Department unrelated to Microsoft's main
9 business as a classic example of circumstances
10 warranting invocation of Section 25137.

11 Because this unrelated to the main business
12 Treasury activity also generated about 73 percent of
13 Microsoft's total gross receipts, compared to only
14 2 percent of Microsoft's total income, the Court sided
15 with the FTB's conclusion that including the activity
16 and gross receipts amounts -- of gross receipts amounts
17 in the formula would disproportionately factor represent
18 within the formula.

19 About six years later, California Court of
20 Appeals in General Mills decision, also agreed with FTB
21 that factor representation by reference to the gross
22 receipts from the General Mills hedging activity, which
23 was not conducted for its own profit, but which
24 generated 30 percent of total gross receipts, while at
25 most 2 percent of total income, was unfair. To remedy

1 the unfairness, the Court invoked Section 25137.

2 Overall, therefore, alternative apportionment has
3 been allowed in situations where a taxpayer was engaged
4 in an activity for reasons other than to make profit or
5 a taxpayer's activity was unrelated to taxpayer's main
6 business and where either of the activities also
7 generated enormous gross receipts but contributed close
8 to zero in income to the total income pie.

9 Without a doubt, in the case before you today, we
10 do not have any of the facts warranting a finding that
11 the standard formula is distortive.

12 Instead, we have two distinct profit-driven
13 activities, with each being directly related to
14 Taxpayer's main business, and each is ratably
15 represented in the apportionment factor by gross
16 receipts each activity generated.

17 Let's take a closer look at how Taxpayer
18 generated apportionable business income and the extent
19 of its activities in California.

20 Most relevant to this case are two legally
21 separate and legally independent business units within
22 Taxpayer's unitary business.

23 On the left, you can see Taxpayer's Industrial
24 Business Unit, with MBUSA LLC selling Taxpayer's cars to
25 unrelated U.S. dealers in the wholesale car market.

1 On the right, we have another, Financial Services
2 Business Unit, which earns separate stream of incomes
3 from providing financing and financial services.

4 When it comes to leases specifically, Daimler
5 Trust is the entity which earns lease revenue from
6 leases it buys from dealers. While the trust acquires
7 the right to receive a stream of income in the form of
8 lease payments, titles to the cars pass through the
9 Trust as part of this single lease purchase transaction.

10 MBFS USA LLC finances the Trust's purchase of
11 leases. And to replenish the funds MBFS loaned to the
12 Trust, MBFS immediately sells the Trust's leases as
13 asset-backed securities to underwriters for cash.

14 The two transactions -- the sale of cars to
15 dealers and subsequent collection of lease payments from
16 consumers -- each is part of Taxpayer's main business,
17 each is conducted for its own profit, and each ratably
18 contributes to the total income pie.

19 Let's take a closer look at each unit's activity
20 and how each activity contributes to the total pie and
21 California's slice of the pie.

22 According to Taxpayer's Annual Reports, which we
23 included with our opening brief as Exhibit F, the
24 Industrial Business Unit car sales to dealers generated
25 a rate of return on sales of about 9.4 and 7.8 percent

1 in 2017 and 2018, respectively.

2 To sell cars, MBUSA and unrelated dealers enter
3 into a Car Purchase and Sale Agreement. Nowhere does
4 the agreement provide for the taxpayer's subsequent
5 option or right or condition to repurchase from dealer's
6 cars which dealers end up leasing to dealer's retail
7 customers. The same agreement also does not impose any
8 expectations or benchmarks upon dealers with respect to
9 their leasing of cars to their retail customers.

10 In fact, outside of Daimler's asserting existence
11 of a separate sell-and-buyback transaction with respect
12 to the leased cars, Daimler did not provide FTB with a
13 single agreement or evidence that supports that such
14 undoing of the original sale actually took place.

15 Consistent with its completed and final sale
16 transaction, Taxpayer increased its total income pie by
17 revenue from car sales and decreased the total income
18 pie by related expenses, including the cost of all the
19 cars it originally sold -- whether or not these cars
20 were later leased.

21 To determine California's slice of the total pie
22 under the standard rules, Taxpayer used gross receipts
23 from the same car sales in order to factor represent the
24 car sales activity within the apportionment formula.

25 This way, the activity that contributes to the

1 total pie is also ratably factor represented in the
2 formula that determines California's slice of the pie.

3 In turn, Financial Services' Business return on
4 equity was about 17.7 and 11.1 percent in 2017 and 2018,
5 respectively.

6 Recall that the Financial Service Business Unit
7 makes profit from its finance-based services and
8 operations. It is not in business of buying or selling
9 cars.

10 One way Financial Service Business makes money is
11 by buying auto leases and selling these leases as
12 auto-lease asset-backed securities to underwriters for
13 cash. All leases originate from dealers leasing
14 dealer's cars to dealer's customers. Pursuant to the
15 same lease agreements with their lease customers,
16 dealers automatically assign all leases, together with
17 titles to the leased cars, to Daimler Trust.

18 To enable the Trust's purchase of the leases,
19 MBFS finances it. And once Trust owns leases, MBFS
20 immediately sells these as auto-lease asset-backed
21 securities for cash. By monetizing leases, MBFS gets
22 access to additional funds to buy more leases, and so
23 on.

24 Note that all lease-related transactions are
25 separate and subsequent to the original sale transaction

1 between dealers and the Industrial Business Unit. While
2 Taxpayer asserts here that it repurchases cars just
3 before leases are extended, this is not possible because
4 California law prohibits Daimler from leasing its cars
5 directly to consumers. In reality, therefore, titles to
6 the leased cars pass to the Trust only as a consequence
7 of its independent purchasing of the right to receive a
8 stream of lease payments from dealer -- from the
9 dealer's customers.

10 Simply put, the Trust must own titles to the car
11 as the collateral in case of lease payment delinquency
12 and as the asset backing the auto-lease asset-backed
13 securities it sells. Available evidence, therefore,
14 conflicts with Taxpayer's assertion that a separate
15 agreement for repurchase of cars took place.

16 Instead, each separate transaction -- a car sale
17 wholesale and car lease retail, despite relating to the
18 same unit of asset -- Car A -- generates distinct gross
19 business receipts, revenue, and expenses. Indeed, by
20 participating in both wholesale transaction and lease
21 financing transaction through its distinct Business
22 Units, Taxpayer earns several streams of income when it
23 comes to the same single car it manufactures. This is
24 not double counting.

25 This is double earning, and the standard formula

1 accounts for these distinct, unrelated to each other
2 business activities by fairly factor representing each
3 activity separately.

4 And, to calculate its total apportionable
5 business income, Taxpayer again increases the total
6 income pie by its lease revenue and reduces the pie by
7 lease acquisition costs to the full extent. To
8 determine the slice of the total income pie under the
9 standard rules, the same activity is factor represented
10 in the apportionment formula by the activity's gross
11 receipts.

12 The next slide neatly supports our statement that
13 auto-lease asset-backed securities were not loans but
14 cash sales. It also further explains why double
15 counting is not an issue in this specific case.

16 Here are some of the excerpts from the taxpayer's
17 Financial Service Business filing with the Securities
18 and Exchange Commission that support our conclusion. We
19 included links to these filings under Footnotes 22 and
20 39 of our brief.

21 For accounting purposes, while lease payments are
22 Taxpayer's accounts receivables, MBFS' sale of leases as
23 asset-backed securities is a sale of Taxpayer's accounts
24 receivables.

25 As noted within the transaction chart on the left

1 of the slide, MBFS received cash from the sale of the
2 note to the underwriters. A bubble on the right also
3 explains that the underwriting involves a sale and a
4 purchase of the notes. A sale is not a loan; a sale to
5 third parties does generate gross receipts.

6 This transaction is relevant to us for two
7 reasons: First, it is relevant because the sale of
8 auto-lease asset-backed securities is part and parcel of
9 the Financial Service Business Unit's business incentive
10 behind its purchasing of auto leases from dealers. It
11 is very doubtful that Taxpayer would acquire leases in
12 the first place without having the plan to immediately
13 sell continual operation -- to immediately sell these
14 accounts receivables in order to replenish the cash
15 necessary for the unit's continual operation as a
16 financier.

17 Another reason we brought up this cash sale of
18 accounts receivables to underwriters is to illustrate
19 Taxpayer's misplaced justification of its
20 double-counting argument by its misplaced overreliance
21 on a case issued by another state's Court.

22 In that case, the Idaho State Court agreed with
23 Idaho State Tax Commissioner that inclusions of account
24 receivables under the accrual method and inclusion of
25 cash receipts from the sale of the same accounts

1 receivables under the cash method was akin to double
2 counting of the same receipts, finding such double
3 inclusion distortive.

4 But for our purposes here, the Idaho State case
5 is not applicable and is distinguishable because it
6 relates to the issue which neither of the parties raises
7 before your Board today.

8 We're not here to determine whether Taxpayer is
9 entitled to include in the sales factor lease payments
10 for which Taxpayer accounts for under the accrual method
11 and cash from the sale of lease accounts receivables
12 under the cash method.

13 Instead, this petition involves a different
14 issue. It involves fair factor representation of two
15 unrelated and distinct business transactions: car
16 sales to Client 1 and lease payments from Client 2
17 pursuant to the assigned lease agreement.

18 Let's quickly summarize.

19 Overall, facts do not support a repurchase
20 transaction or double counting of gross receipts takes
21 place. One unit's car sales to dealers and another
22 unit's lease acquisition are two completely separate and
23 unlinked to each other, regular business transactions.

24 MBUSA did not contract to repurchase leased cars.
25 In fact, it did not repurchase cars.

1 Financial Services Business is not in the
2 business of buying cars. Instead, it owns titles to
3 cars, merely as a consequence of lease assignment and as
4 the requirement for issuing auto-lease asset-backed
5 securities which it sells for cash.

6 Despite Audit asking for all evidence in support
7 of Taxpayer's position, Taxpayer did not provide a
8 single agreement or evidence that supports presence of a
9 separate repurchase transaction.

10 Taxpayer's financial statements and Taxpayer's
11 investor prospectuses filed with the Securities and
12 Exchange Commission also did not allude to repurchase.

13 What Annual Reports make clear is that each
14 activity generated comparable profits despite relating
15 to the same unit of car. In turn, investor prospectuses
16 also make clear that the titling trust's ownership of
17 titles to leased cars was a necessary component of that
18 unit's ability to monetize leases by selling these as
19 auto-lease asset-backed securities to underwriters.

20 Title ownership by Financial Service Business
21 Unit secured future payments to investors. It did not
22 undo any prior sale of the cars to dealers by a
23 different unit.

24 Overall, car sales to dealers and lease payments
25 from dealers' clients were two independent business

1 transactions with unrelated parties. Each activity was
2 part of Taxpayer's main business, and each was entered
3 into for profit.

4 While each activity related to the same cars,
5 each generated separate and comparable returns, while
6 none generated disproportionate gross receipts.

7 Factor representation of each activity, by
8 reference to its gross receipts, is fair, and does not
9 amount to double counting because unitary principles do
10 not eliminate tax consequences of two distinct business
11 transactions with unrelated parties.

12 Now let's take a look at how many cars MBUSA
13 sells to car dealers and how many leases owned by
14 Financial Service Businesses trace back to California
15 consumers.

16 During audit, Daimler reported that about
17 11 percent of its car sales were to California dealers
18 and about 26.5 percent of car leases were with
19 California consumers.

20 On average, these two activities together
21 generated about 19 percent of its total apportionable
22 business income in California. Again, 19 percent is the
23 cumulative extent of Taxpayer's activities in the state
24 when you consider sale of cars to Client 1 and lease
25 payments received from Client 2.

1 In turn, standard apportionment formula sources
2 only 13 percent of these activities to California.

3 As you can see, standard rules do not over source
4 to California the taxpayer's income from these
5 transactions, 19 percent of which are in California. In
6 fact, the standard apportionment factor appears to under
7 source it.

8 This slide illustrates -- this slide illustrates
9 that Daimler calculates its total income pie by
10 reference to revenue and expenses produced by its car
11 sales to Client 1 as well as to the --

12 Can you do Slide 16, please?

13 -- as well as to revenue and expenses --

14 The pie. Thank you.

15 -- as well as to revenue and expenses separately
16 generated by car leases to Client 1 and 2.

17 Yes. No. Thank you.

18 16. A green pie.

19 Pursuant to the standard rules, California's
20 slice of the total income is also determined by
21 reference to gross receipts from car sales to Client 1
22 and from car leases to Client 2. Not more, not less.

23 This means that when it comes to determining the
24 slice, sales and leases are separately and ratably
25 factor represented by their respective gross business

1 receipts because each separately contributing to
2 composition of the pie.

3 It is apparent, therefore, that standard single
4 sales factor formula does fairly represent the extent of
5 Taxpayer's California business activity by producing for
6 separate factor representation of each activity using
7 its respective gross business receipts.

8 Daimler does not just sell cars. After it sells
9 cars to unrelated dealers, Daimler ends up earning
10 another, separate stream of revenue when it purchases
11 car leases as part of its Financial Service Business.

12 Again, this is not double counting of the same
13 receipts. Instead, this is double earning, which is
14 separately factor represented in the standard formula.

15 The formula is fair because it relies on fair and
16 ratable factor representation of each separate business
17 activity that contributes to the pie.

18 Taxpayer, however, wants to factor represent less
19 than its actual business activities in California. To
20 get to a smaller California slice, Taxpayer seeks to
21 reduce MBUSA's actual gross receipts from its completed
22 car sales by another unit's business costs.

23 Taxpayer's approach ignores the fact that
24 Financial Services Business subsequent and separate
25 lease acquisition from dealers does not undo any of the

1 previously completed car sales to dealers by MBUSA.

2 Its approach is also inconsistent with Taxpayer's
3 calculation of its total income pie, which Taxpayer
4 reduces when it deducts from its total sales revenue the
5 cost of the cars sold, despite the fact that the same
6 cars were also later leased.

7 In essence, Taxpayer's approach results in a
8 mismatch between activities that make up the total
9 income pie with the activities which contribute to the
10 mathematical formula used to calculate California's
11 slice of the pie.

12 Put otherwise, Taxpayer requests a formula that
13 suits Taxpayer better because it produces more than
14 38 million in refunds, which is only made possible by
15 Taxpayer's underrepresenting its actual business
16 activity in the apportionment formula.

17 But Section 25137 does not authorize deviation
18 from the standard rules simply because Taxpayer's
19 proposal would source less income.

20 Fair factor representation is the standard
21 requirement. Here, given that the standard formula
22 aligns business activities that contribute to
23 calculation of the income pie with the activities that
24 contribute to the calculation of California's slice of
25 the total pie, the application of the standard rules

1 results in fair factor representation of Taxpayer's
2 overall business activities in this state.

3 Despite numerous information and documents
4 requests, Taxpayer failed to provide evidence that
5 support Taxpayer's petition. As is, evidence does not
6 provide Taxpayer with sufficient basis to overcome its
7 business of proving by -- its burden of proving by clear
8 and convincing evidence that application of the standard
9 formula unfairly represents the extent of its California
10 business activities.

11 The standard formula that separately and ratably
12 accounts for each business activity does fairly
13 represent the extent of such business activities.

14 So where do we go from here?

15 Given that Taxpayer failed to carry its burden of
16 proving the first prong of the test, the law directs us
17 at a hard stop. We need not address the question of
18 whether proposed alternative is reasonable. Standard
19 rules do what they must do: They are fair in Taxpayer's
20 case, period.

21 However, if we were to address reasonableness of
22 the proposed alternative, the same facts also support
23 our finding that the proposed alternative is
24 unreasonable.

25 This slide merely compares standard with

1 Taxpayer's proposed formula, with the proposed one
2 simply providing for a smaller California slice of
3 Taxpayer's total income pie.

4 As mentioned, Courts have not found distortion
5 merely because the standard rules result in more or less
6 tax to California, and mere difference between the two
7 figures derived under two different accounting methods
8 also does not prove that one set of figures is
9 distorted.

10 Here, Taxpayer's proposed alternative result --
11 alternative results in a smaller slice simply because
12 its formula disproportionately factor represents
13 distinct business activities we just discussed.

14 Simply put, Taxpayer seeks to cancel out one
15 Business Unit's complete sale by another unit's cost of
16 doing business. In a way, Taxpayer direct -- indirectly
17 calls for treatment of these two separate market
18 transactions as if they were intercompany, or as if
19 entered into between the Industrial Business and
20 Financial Service Units directly. But evidence clearly
21 provides otherwise.

22 While the party proposing an alternative must
23 carry the burden of proving by clear and convincing
24 evidence that the proposed remedy is reasonable, here,
25 Taxpayer cannot sustain this burden because standard

1 formula already provides for fair factor representation
2 of distinct business activities.

3 Taxpayer's premise that lease acquisitions
4 somehow undoes an already completed car sales by another
5 segment is also inconsistent with its own facts and its
6 own claiming of two separate expense deductions related
7 to the same car.

8 As briefly covered already, when it comes to
9 determining California's slice of total income, or the
10 apportionment factor, Taxpayer treats leases as
11 transactions that undo prior wholesale transactions.

12 Yet, when it comes to determining its total
13 income, or the pie, Taxpayer does not treat leases as
14 transactions that undo the wholesale transaction.
15 Instead, it claims full deduction for the cost of the
16 cars it sold and another deduction for the cost of
17 leases, treating each transaction as final and separate.

18 Taking Taxpayer's argument that lease acquisition
19 cancels out or undoes the original car sales to its
20 natural conclusion requires us to reverse the originally
21 claimed deduction. Otherwise, Taxpayer is treating the
22 same car as if sold for purposes of calculating the pie,
23 and as if unsold for the purposes of calculating the
24 slice. This is not a reasonable method of assigning a
25 portion of total income to California.

1 As such, Taxpayer's proposed alternative that
2 produces more than 38 million in refunds is not
3 reasonable.

4 Here is a visual of what the standard formula
5 looks like compared to the proposed alternative.

6 On the left, we have our standard formula just as
7 discussed. There, each separate activity contributes to
8 determination of the pie and of the slice.

9 On the right, we have Taxpayer's proposal, which
10 calculates the pie identically to the standard method
11 but calculates the slice by factor representing only one
12 of the two activities.

13 Instead of being fair, Taxpayer's proposal
14 artificially and unfairly skews representation of
15 Taxpayer's activities in favor of a single activity
16 which has a smaller California presence. Hence, it
17 sources to California only 10 percent of the wholesale
18 transaction with 11 percent California presence as well
19 as of the lease payments, 27 percent of which also
20 originate in California.

21 This slide clearly illustrates the very reason
22 why Taxpayer's proposal is not reasonable.

23 In conclusion, Taxpayer did not sustain its
24 burden of proving by clear and convincing evidence that
25 the application of the standard rules unfairly reflects

1 the extent of its California business activity and that
2 Taxpayer proposed alternative is reasonable.

3 The standard formula as it applies to Taxpayer in
4 this case is fair.

5 This concludes our presentation.

6 Thank you for your attention to this matter. We
7 hope to have an opportunity to respond to any questions
8 you might have.

9 CHAIRPERSON COHEN: All right. Thank you. Thank
10 you very much for your presentation.

11 Let me just check in with my colleagues to see if
12 there's any questions.

13 Thank you, guys. I got this.

14 MEMBER VAZQUEZ: I will wait for the rebuttal.

15 CHAIRPERSON COHEN: Okay. All right. We'll go
16 ahead and go into the rebuttal then. Thank you.

17 MR. WHITNEY: Honorable Board Members, thank you
18 for the opportunity to respond to FTB staff's comments.

19 These comments, which we do have summarized on a
20 slide, are represented in the brief that they filed.

21 And so I will walk through these, each in turn.

22 The first argument is that there is no repurchase
23 because effectively you have got separate entities with
24 separate profit motives. This is putting form over
25 substance. We are a single unitary group. We are

1 required, under California law, to file a single
2 combined report. So when we sell vehicles to
3 dealerships, as required by California Vehicle Code,
4 there's no other way to do it.

5 If we choose to do a leasing, if we want to do a
6 leasing, we have got to buy the vehicle back. And I
7 don't think that that is in dispute. The vehicles are
8 purchased by our leasing affiliate.

9 The dealerships are in business to make money.
10 They are not going to sell the car that they just
11 bought, you know, for example, for \$50,000, for a penny
12 less than \$50,000 to us.

13 So when your left hand is selling a \$50,000
14 vehicle to a dealership and your right hand is buying it
15 back in a leasing subsidiary for the same \$50,000, you
16 are not making any economic profit on that transaction.

17 You heard FTB counsel talk about wholesale sales.
18 Yes, we do sell vehicles to dealers that we don't buy
19 back because they are not leased. Customers do come in,
20 and they do choose to purchase cars. Other customers
21 may come in and choose to lease vehicles.

22 When we sell wholesale to retailers, to dealers,
23 and we don't buy them back, there is profit. And so,
24 yes, there is a profit margin when we don't buy the
25 vehicles back. And I think that it's pretty clear that

1 if you are selling for \$50,000, the dealer is selling
2 back to us for at least \$50,000, we're not making any
3 economic profit. In fact, we are providing the dealer
4 with incentives so that they will serve the customer.
5 If the customer wants to purchase the vehicle, they have
6 equal incentive, as compared to a customer that wants to
7 lease the vehicle.

8 We heard some things about the percentages and
9 how, you know, maybe 12, 13 percent is fair because
10 under their calculation, 19 percent -- suggesting that
11 19 percent or one out of every five vehicles is sold in
12 the California market.

13 This completely overlooks the facts that only
14 5 percent of our trucks and buses are sold in California
15 at all. And they are not leased. They are not double
16 counted. They are predominantly sold outside the state.

17 This double counting -- and assuredly it is
18 double counting again -- to the extent you are leasing
19 and you are selling to a dealership and then buying it
20 back for at least that amount and then receiving the
21 lease payments, that's double counting. You are
22 repurchasing the title to the vehicle -- I think that
23 was acknowledged -- as well as the lease payment stream,
24 which was also acknowledged.

25 That is clearly double counting. You are selling

1 the vehicle. You are capturing the value of the vehicle
2 once. That's what you are required to do under
3 California law, under the Vehicle Code. I have to sell
4 to a dealer, and when I purchase back and then receive
5 the same value of the car again, in the form of
6 lease-related payments, that, clearly, is double
7 counting.

8 We heard about ABS being included, possibly in
9 the factor or being a sale.

10 Yes, we sell securities in the same way that the
11 government sells Treasury bills or government bonds.
12 You are not selling a product that you produce. That's
13 called borrowing money. Pure and simple.

14 Now why do they do this? Because secured
15 collateral, collateralized loans, you get a lower
16 interest rate for that, just like on your mortgage
17 versus your credit card. When you borrow money on your
18 credit card, you know, you may be facing a 19 percent
19 rate. There's no collateral securing it.

20 When you buy a house, you know, your mortgage
21 rate even these days is a lot lower than 19 percent.
22 That's why they do it this way. It is secured by
23 underlying assets. And they do it to borrow money to
24 provide funds needed effectively at the end of the day
25 to build more cars, to sell cars to California customers

1 whether it's a sale or a lease.

2 No, this wasn't included in the sales factor and,
3 no, it wasn't treated as an income item. This is a
4 borrowing transaction. It is not in the federal return;
5 it is not in the California return. Furthermore,
6 apportionment work papers were provided to the auditor
7 that were traced back to both of the returns. The
8 apportionment agrees with the underlying returns.

9 There's no borrowing in there because when you
10 borrow money you have to pay it back. There's no
11 income. If there's no income, there's no receipt.

12 We heard also that if you do remove the
13 double-counted sales to get to fair apportionment,
14 keeping in mind that with only 11 percent of our cars in
15 California and only 5 percent of buses, how in the world
16 would you ever get to a 19 percent apportionment
17 percentage? Or for that matter, how would we ever get
18 to a 12 or 13 percent apportionment? The answer is, by
19 double counting these activities that are being unwound.

20 If we could, we would lease directly to
21 California customers and we wouldn't be here today. We
22 wouldn't have double counting. We would have the
23 8 percent apportionment percentage because you wouldn't
24 have that first sale to the dealer that is in the
25 standard apportionment formula. We're here because

1 California Vehicle Code doesn't allow us to do that
2 direct leasing to our customers. That's why we sell.
3 That's why we buy back.

4 The depreciation deductions, again, is mixing up
5 the tax base or the total pie with the fair
6 apportionment question. The depreciation deductions
7 have been reviewed by both the IRS and the FTB audit
8 staff. They did the work. There's no adjustment to the
9 depreciation. It's a valid deduction.

10 It's not a "gimme" or some sort of credit or tax
11 break. We have paid real money to buy this asset back
12 from the dealers. And the dealers, you know, were on
13 the hook for that money to us when they purchased it
14 from us. So we're paying money to get that back.

15 That needs to be accounted for in some fashion.
16 California law does not allow full expensing of fixed
17 assets that are purchased up front. It requires
18 depreciation to be taken over time, over the course of
19 the lease.

20 The idea is, is that the depreciation deduction
21 kind of mirrors the declining value of the auto over
22 time. As you drive it off the lot and you use it
23 pursuant to the lease, it matches. It fair -- it's
24 fair. It's required.

25 FTB Legal Ruling 2019-1 says that the timing and

1 the value of deductions has no place here in fair
2 apportionment considerations. We're talking about, is
3 it fair to include sales to dealerships that we buy back
4 and then have lease receipts? Is it appropriate to
5 double count that? That's the question. Not
6 depreciation deductions.

7 Next, the alleged lack of documentation at audit.
8 Respectfully, this audit went for two years. We
9 responded to every single IDR that was issued. We
10 provided reams of information, some of which are
11 summarized here: financial statements, detailed trial
12 balance information with account-level detail that
13 showed the sales to the dealerships and the purchases in
14 separate accounts back from the dealers and the leasing
15 activity.

16 We did provide intercompany transaction detail,
17 apportionment work papers which were detailed, which
18 tied back to the returns, both California and federal.
19 We had the client run query reports of lease
20 acquisitions from the approximately 50 California
21 dealers in California, each one of them, to come up with
22 the total amount of lease purchases. We provided dealer
23 agreements and lease contracts.

24 Never, over the course of the two-year audit, did
25 the auditor say he didn't have enough information to

1 ascertain the basic facts that there was a sale to
2 dealerships, and when people lease there is a repurchase
3 of that leased vehicle back.

4 In fact, if you look at the auditor's
5 determination letter, it says the exact opposite, as
6 you'll see here. He was able to look at the trial
7 balances, he could see sales to authorized dealerships
8 and the purchase of those vehicles back by the financial
9 subsidiary. The leasing affiliate. He could see it in
10 the detailed trial balance information provided.

11 In addition, the annual reports are clear: There
12 are sales to dealers, and then there's a repurchase that
13 goes into the leased equipment accounts. This is a
14 German company. The primary financial statements are
15 issued in German.

16 As translated in the best English that they are
17 using here, it says, "being of the magnitude." Now
18 maybe you or I would say, "same amount." You know, that
19 is clear. They said, "being of the magnitude." The
20 amount. The sale to the dealership, the repurchase that
21 goes into the leased equipment is of the same amount.

22 How in the world can you have an economic profit
23 on that? Of course we have economic profit on the
24 wholesale sales that we don't buy back, but when we buy
25 it back for the same amount or more, how could we

1 possibly profit from that? That is a double counting of
2 the receipt that we only do because California law won't
3 less -- let us lease directly to our customers. We have
4 to sell to authorized dealerships and buy the product
5 back.

6 In terms of documentation and contracts, they
7 show that the dealers routinely initiate the leases and
8 then transfer them to the Trust. MBFS collects the
9 lease payments on behalf of the Trust. It's all here
10 and all very clear from the information that was
11 provided. There was no confusion on the part of the
12 auditor what was going on.

13 Really, the issue is fair apportionment and does
14 it make sense that for the wholesale sales that you buy
15 back -- not the other wholesale sales where -- they are
16 in the factor -- but the ones that we sell because we
17 have to under California law and buy back and then
18 receive leasing -- payments on same vehicle, do we have
19 to double count? Is that the only way we can get the
20 fairness? I don't think so.

21 We have 11 percent of our cars and only 5 percent
22 of trucks and buses. We're winding up with 12 or
23 13 percent precisely because we're double counting these
24 sales, and it's pulling in those profits on the trucks
25 and buses that we only sell 5 percent in this state.

1 And so with that, I will -- I will turn it over
2 to Jon for any further rebuttal and conclusion.

3 MR. SPERRING: Sure. Yeah. One point I would
4 like to --

5 CHAIRPERSON COHEN: Can someone turn my mike on?
6 Thank you.

7 How much time do they have?

8 MS. RUBALCAVA: They have about five more
9 minutes. Although the Petitioner still has another 20
10 minutes available that they reserved from their opening
11 argument.

12 CHAIRPERSON COHEN: Great. Thank you.

13 MR. SPERRING: Yeah. We won't use that. We will
14 do about five. Be respectful of your time.

15 You know, one of the comments that I heard that
16 really sort of didn't surprise me but I wanted to really
17 focus on it, is you heard, "There's no double counting.
18 There's double earning." Okay?

19 But what you didn't hear was where is this double
20 earning coming from? Okay. It -- we buy the cars back
21 from the dealers at the same price. That's not double
22 earning. What you hear, the double earning they are
23 talking about, is from the float on the interest. Okay?
24 For the leases, right? We will go and issue ABS at a
25 lower rate than we charge the consumer on the lease

1 transaction.

2 That income is picked up in the lease payments,
3 right? That's why you have the gross receipts on the
4 lease payments and the residual sale. You don't need to
5 pick up this unwound sale to pick up any, quote/unquote,
6 "double income." Okay?

7 Yeah, there's double income from financing cars.
8 And those, all the receipts associated with that,
9 quote/unquote, "double income" is in the lease payments.

10 There's absolutely no need to pick up this
11 unwound sale, right? Instead, we hear semantics, it's
12 not -- there was no evidence that there was a
13 repurchase. Of course there's no evidence there's a
14 repurchase. Because it wasn't a repurchase. It was the
15 separate entity. Okay?

16 So that is why it's not a repurchase. But they
17 all know that it's -- we did repurchase it. The unitary
18 group did buy it back. It was a separate entity; so
19 that word "repurchase" is not technically correct. But
20 that is the economics of what happened, right?

21 And so for them to argue otherwise is incredibly
22 disingenuous. And so with that, I will start my
23 prepared remarks.

24 Double counting gross receipts associated with
25 leased vehicles artificially inflates Daimler's sales

1 factor to such an extent that alternative apportionment
2 is not only warranted but mandated.

3 Excuse me. Let me find myself. Okay.

4 The Franchise Tax Board has consistently taken
5 the position that receipts generating little or no
6 economic profit must be removed from the apportionment
7 formula. The FTB first litigated this position
8 successfully some 45 years ago in the landmark Pacific
9 Telephone and Telegraph case.

10 During the entire course of the
11 two-and-a-half-year audit and petition process, FTB has
12 not articulated a single reason why double counting
13 leased vehicles fairly reflects Daimler's vehicle sales
14 in California.

15 FTB has had every opportunity to explain how the
16 situation illustrated on Slide 18, in which 10 percent
17 of the vehicles are sold in California, but the standard
18 formula apportions 18 percent to California, simply by
19 virtue of the fact that California vehicles were leased
20 while the vehicles in the other states were not, could
21 ever be fair apportionment.

22 Instead you heard them look at Daimler's
23 apportionment numbers, and they did not tell you about
24 the Freightliner trucks that are all sold out of the
25 state, 95 percent. Nor do they tell you about the

1 Thomas Built Buses that are sold outside of the state.
2 Okay? Nor do they tell you about the Thomas Built --
3 Thomas Built Buses and Western Star Trucks, right?

4 Those are all three entities, very little
5 presence in California, very little sales. But there's
6 no mention of that. And there's no mention of this
7 18 percent. Okay?

8 Instead, the FTB has offered up a half a dozen
9 red herring arguments in an effort to divert attention
10 away from fair apportionment question.

11 But don't be misled. The fairness of the
12 apportionment formula is the sole issue before this
13 Board, not the pie, not the depreciation, just that
14 formula in front of you.

15 Daimler is simply requesting the remedy the FTB
16 has imposed on hundreds of taxpayers over the decades.
17 That is the removal of receipts that generate zero
18 economic profit. This remedy is simple and consistent:
19 Remove double-counted receipts from undone sales to the
20 dealers which produce no economic profit.

21 Granting Taxpayer's petition not only avoids
22 gross distortion, but is fair, logical, and fully
23 consistent with the alternative apportionment adjustment
24 made by FTB staff for decades.

25 Thank you, Madam Chair, and Honorable Board

1 Members. We conclude our remarks.

2 CHAIRPERSON COHEN: Thank you very much.

3 All right. This matter is back in this body's
4 hands.

5 Let me check and see if there's any -- I'm sure
6 you have questions.

7 MEMBER VAZQUEZ: Yes.

8 CHAIRPERSON COHEN: I will let you go first. Let
9 me also check in with Gayle Miller online.

10 Member Miller?

11 MEMBER MILLER: Thank you so much, Madam Chair.

12 Well, I will defer to --

13 CHAIRPERSON COHEN: Okay.

14 MEMBER MILLER: -- Member Vazquez and then ask
15 questions.

16 Thank you.

17 CHAIRPERSON COHEN: Okay.

18 MEMBER VAZQUEZ: I will -- thank you, Madam
19 Chair.

20 My first question is, I guess, to our staff here
21 on the FTB side.

22 On the repurchase, kind of walk me through this.
23 Because, you know, I'm thinking, when I have leased
24 vehicles, you know, you never really take ownership of
25 these things. You are just basically leasing them. And

1 then at the end of your lease you are giving it back.

2 So I'm a little confused here in terms of a
3 double sale. It's -- it never really sells. So I guess
4 I need a clearer definition from you.

5 MS. KRASAVTSEVA: Sure. Thank you for your
6 question.

7 When MBUSA sells cars to dealers, they realize
8 revenue and claim expenses, right? That's their first
9 transaction. That's the sale.

10 When the dealer leases the car, leasing is an
11 alternative to sale. It is a finance. It is a rent,
12 right?

13 MEMBER VAZQUEZ: Right.

14 MS. KRASAVTSEVA: But it doesn't come at a cost.
15 It comes at an interest rate.

16 So your lease payments are never at the cost. It
17 is -- has a revenue, a margin, which is the interest you
18 pay when you lease a car.

19 So that margin is a revenue. Had the dealers not
20 sold the lease with the car back to Daimler, then the
21 dealers would earn lease revenue, which would be the
22 lease payment less the cost that it paid when it
23 purchased the car. And the difference would be the
24 interest, plus any markup that dealers put on a car when
25 they lease it.

1 Because when you lease car, you negotiate the
2 price of the car, right?

3 And so dealers are there to make money, just as
4 the taxpayer pointed out. So when dealers negotiate,
5 they value the fair market value of the car that you
6 lease, it is necessarily more than what they paid, plus
7 the interest on the payments, because you are leasing
8 the car and you are paying for the benefit.

9 So when the dealers call the title to the car --
10 right? -- while you are leasing it, they can't really
11 sell it. It is yours while you are leasing it, correct?
12 Just like an apartment cannot be leased if it's already
13 rented.

14 And then if the owner of the leased car decides
15 to purchase it, then you pay the difference that you
16 negotiated in the beginning, right? Or you can
17 renegotiate it based on mileage or however it is.

18 But it is a separate transaction. And it has
19 separate types of revenue. Just because Taxpayer buys
20 those leases does not mean that it's a zero-sum game.
21 The dealer, when it sells leases to the Daimler, what it
22 does is transfers rights to the stream of payments that
23 already have that interest incorporated in the formula
24 of the revenue. So the taxpayer buys leases as part of
25 their financial leg, financial operation. And on that,

1 it makes money.

2 How does it make money? Well, it also reduces
3 its risk by selling those leases, right? So they have a
4 lot of leases that they purchase, they bundle them in
5 securities, they sell them, and they sell them in a
6 bond-like security. It's a debt security, right?

7 So they receive cash, but they have to pay
8 interest to the investors holding that bond. There's
9 usually a difference between the interest they receive
10 on the lease payments from the lessee and the interest
11 that they pay to the investors that invested in the
12 bond. And that's how financial leg makes money. It is
13 not in business of holding cars or buying cars.

14 The cars is -- the title to the car, they hold,
15 but as a security. And then, of course, if the lessee
16 returns the car, then they sell the car, or maybe they
17 sell it back to dealer, or maybe the dealer just buys
18 it. We are not really here to see what they do with
19 that car after, right?

20 We are seeing, "Okay. Well, how is the slice
21 calculated?" When the dealer sells the car, they
22 calculate their pie by including revenue from that sale
23 of the car and the reducing that apportionable income
24 pie by the expenses, their cost of goods sold, which is
25 cars that they sold, right?

1 And then when they -- Daimler's financial arm
2 buys access to stream of payments that already has
3 interest incorporated in those payments, and margins
4 incorporated in those kind of payments, that's another
5 stream of income.

6 So how do you deal with that by just discounting
7 it? What Taxpayer is here telling us is that "Ignore
8 that we bought a stream of payment. Imagine that we
9 simply bought cars." But they didn't. They bought a
10 stream of payment. It's a financial transaction.
11 There's a financial revenue.

12 And isolating cost from the actual revenue
13 doesn't make any sense, because they are looking at the
14 repurchase at their cost as a nonprofitable transaction.
15 Well, cost is not revenue. Cost is something that
16 reduces revenue.

17 So when they purchased stream of lease payments,
18 they also acquired a car with it, because it comes
19 together as a security, but the lease acquisition cost
20 is not gross receipts. It's cost of doing business.
21 For them to receive stream of payment, they have to pay
22 for it. It doesn't reduce gross receipts.

23 MEMBER VAZQUEZ: Okay. Let me go back here to
24 the Petitioner on this end.

25 So your argument is that -- because I know at the

1 end of the day, when you lease a vehicle, the dealership
2 basically turns over the deed to the -- in this case, I
3 guess it's Daimler -- right? -- that handles this thing.
4 And you, as the lessee, never really take ownership
5 unless you actually buy out the lease at the end of the
6 lease.

7 So you are basically -- like staff was mentioning
8 here, you are basically just renting the vehicle.

9 MR. SPERRING: You are correct. And the --

10 MEMBER VAZQUEZ: And at the end of the lease you
11 are returning it back.

12 MR. SPERRING: Yeah. You are absolutely correct.
13 The lessee does not obtain the title of the car. And so
14 what happens is, to your point, is, Daimler has that
15 first sale to the dealer. The dealer has title.

16 Then when Daimler repurchases it, when their
17 finance arm repurchases it back, the title goes to the
18 finance arm. And so you are right: The lessee never
19 gets title to the car.

20 MEMBER VAZQUEZ: But the lessor, I guess, at that
21 point, takes title -- well, basically buys it out at
22 that point.

23 MR. SPERRING: Exactly.

24 MEMBER VAZQUEZ: And then it frees up the dealer
25 from owning -- basically owning that car so then they

1 can go ahead and buy other vehicles, I imagine.

2 MR. SPERRING: Exactly.

3 And the key point here is all the income from
4 that transaction -- right? -- is coming from the lease
5 payments and the residual sale. There is no income
6 associated with that undone sale.

7 So when you hear about deductions being taken out
8 of the apportionment formula and there's a double
9 earning of income, that's completely nonsense, right?

10 That original sale that's undone generates zero
11 income. All the income is from the lease payments and
12 the residual sale.

13 I'm going to turn it over to my colleague.

14 MR. WHITNEY: Yeah. No. I think, Jon, you
15 stated it very well.

16 You know, interest, just maybe to clarify a few
17 things, is a payment for the use of money, whereas a
18 lease payment or rent is a payment for the use of
19 something, like either a house, an apartment, or a car.
20 So we heard a lot that the lease payment is just
21 interest. And that -- that's not true. The car is
22 declining in value over the course. As soon as you
23 drive it off the lot.

24 And so the lease payment is to take into account
25 that declining value. You know, the wear and tear on

1 the vehicle. There is an interest component, but that's
2 not the largest piece.

3 The main drivers are, you know, that loss in
4 value and really the residual value. What the car is
5 worth at the end. Which they try to sell it for at --
6 you know, at the end. They do sell it for at the end of
7 the lease.

8 You know, we heard about the ABS as well. Again,
9 this is secured financing. This is the way they borrow
10 money. It's not income. It's not -- it's interest that
11 you have to pay to the investors.

12 The investors are not acquiring -- I also heard
13 "acquiring the lease." They are not. The investors are
14 not interested in getting into the leasing business.
15 Our leasing company retains the title. They are doing
16 secured financing, secured by the value of the cars that
17 they own, that they bought back from the dealerships.

18 And they're -- again, the reason why they do that
19 is they can get a lower interest rate than if they just
20 went to lenders and tried to borrow unsecured financing,
21 just like your credit card carries a higher interest
22 rate than your mortgage.

23 So I wanted -- just wanted to clarify those few
24 points.

25 But, you know, Jon, you answered most of them.

1 MEMBER VAZQUEZ: So once the dealership sells
2 that -- basically that vehicle to the lessor, I guess,
3 they never take back ownership of that pink slip,
4 basically. They don't own it at that point.

5 MR. WHITNEY: No, you are -- you are absolutely
6 right again. The dealership, when they sell it to the
7 leasing company, the Daimler leasing company, they are
8 done with it.

9 MEMBER VAZQUEZ: Right.

10 MR. WHITNEY: We bought it back from them. We
11 own it now, and we are getting the lease payments.

12 MEMBER VAZQUEZ: Okay. Well, go ahead. I
13 have --

14 CHAIRPERSON COHEN: Go ahead. Finish your
15 questions, and I will get to mine.

16 MEMBER VAZQUEZ: And then, I guess, going back
17 now to our staff here, it's my understanding, in looking
18 at -- over this information and then hearing your
19 presentation, it doesn't sound like we've actually -- we
20 did a full-blown audit.

21 Am I correct?

22 MS. KRASAVTSEVA: This was a claim for refund
23 that Taxpayer failed -- filed. And when Taxpayer files
24 this claim for a refund, it told us that it's entitled
25 to refund because it wants to use alternative

1 apportionment. It is on the taxpayer to prove that it
2 is entitled to the alternative apportionment. And by
3 "alternative apportionment," I mean deviation from the
4 standard Code rules.

5 So the taxpayer originally filed under the rules,
6 and then it decided that it does not -- it should not be
7 filing under the standard rules but should be entitled
8 to an alternative apportionment. This is why we're here
9 today.

10 So in order to receive an alternative
11 apportionment, you have to provide evidence that
12 entitles you to that, by clear and convincing evidence,
13 right? So it has to be very clear that your position --
14 the standard rules somehow do not fit for you, right?

15 So the taxpayer, during this two year's audit,
16 did not provide a single agreement that shows us that a
17 repurchase takes place. We do not have an agreement
18 between dealer and the financial arm as to the purchase
19 of cars. We only have lease agreement assignment with
20 the customer.

21 We don't know under which terms the financial arm
22 agreed to buy those from dealers. We have no idea.
23 Because Taxpayer did not provide us with that
24 information. Taxpayer stated to us somewhere during the
25 audit information document request responses that they

1 paid to dealer for their services of leasing.

2 We don't know if those payments of leases --
3 lease services were part of lease acquisition costs or
4 maybe counted separately. We have no idea how much the
5 same cars were purchased for. Were they purchased with
6 a margin or not?

7 So we did ask for all information that would
8 support their claim. And they provided us with
9 information that does not support their claim.

10 CHIEF COUNSEL BRUNETT: So, Member Vazquez, just
11 to summarize what Irina -- I'm sorry -- was saying was
12 that -- your question, is, yeah, we weren't able to do
13 maybe a full audit we would have wanted to do because we
14 didn't get the documentation. So at that point, we did
15 move on when they didn't provide it.

16 So thank you.

17 MR. SPERRING: So -- yeah. Can I address that?

18 MEMBER VAZQUEZ: Let me go back to the Petitioner
19 then.

20 MR. SPERRING: Sure, sure. Yeah.

21 MEMBER VAZQUEZ: Because it's my understanding
22 that you thought you did. But maybe --

23 MR. SPERRING: Yes. We provided -- we responded
24 to every IDR that was issued. And as we put on our
25 slide, the auditors had no issue with the documents

1 provided.

2 Okay. What you are seeing is Legal saying, "Oh,
3 I wish the auditors would have asked for more. And the
4 burden of proof is on the taxpayer; so we're going to
5 come up with things that the auditor could have asked,
6 second-guess the auditor, and then say, 'Taxpayer didn't
7 provide it, you lose, you didn't meet the burden of
8 proof.'" "

9 But the fact of the matter is, in the Distortion
10 Committee hearing, which was made up of both law -- the
11 Legal Department and the Audit Group, there was never
12 one question directed at the taxpayer about this
13 information.

14 There was, you know, no comment at all that they
15 needed additional information from us, that there was
16 concern about the price paid. And the bottom line is,
17 the financials clearly indicate that there is no profit
18 made off these buybacks.

19 CHAIRPERSON COHEN: May I ask a quick, follow-up
20 question?

21 MEMBER VAZQUEZ: Sure. Go ahead.

22 CHAIRPERSON COHEN: This is to you, Ms. Brunett.
23 Is the auditor here in this hearing, and are they
24 available to answer some questions?

25 CHIEF COUNSEL BRUNETT: The auditor is not. The

1 auditor is in Chicago, but Irina can answer -- she's
2 been, you know, in contact with the -- with the Audit
3 staff in terms of what Irina mentioned and what I
4 represented in terms of what we have done in terms of
5 the documentation requested.

6 CHAIRPERSON COHEN: So this documentation that
7 you say that they do not support -- that they did not --
8 that they did not provide, what I'm hearing is, is that
9 you are saying, "They did not provide it," and they are
10 saying, "Hey, you never requested it. You know, we
11 [sic] never asked us to provide it."

12 So my question is, did the auditor actually make
13 a -- I think you called it an "IDR" -- make the formal
14 request for this information that you say that the
15 Petitioner did not provide?

16 CHIEF COUNSEL BRUNETT: It's my understanding,
17 Irina -- correct me if I'm wrong -- that we did issue an
18 Audit staff -- did issue an IDR, and we got back summary
19 information that wasn't the full report of the
20 documentation.

21 But Irina or Delinda, please correct me if I'm
22 wrong.

23 MS. KRASAVTSEVA: We have requested specific to
24 this issue about eight different IDRs, if not more.
25 Those IDRs are often -- because it's a claim for refund

1 and because the taxpayer in a better position to know
2 what they are trying to prove, our questions are open
3 ended. They are telling, "Okay. Please establish,
4 please support this number, please establish your claim,
5 please explain this and that."

6 We cannot ask a specific question without knowing
7 exactly what they are doing. It is on them to explain
8 to us that what they are doing and support it with
9 documentation. So --

10 CHAIRPERSON COHEN: Ms. Irina, it sounds like --
11 you're right. You probably cannot -- you cannot ask the
12 initial question, but there seems to -- it sounds like
13 there was back-and-forth, a rebuttal. They came back
14 and said, oh -- they -- "If there's more information
15 that you wanted or needed, for what reason did you not
16 formally ask for it" --

17 MS. KRASAVTSEVA: Correct.

18 CHAIRPERSON COHEN: -- "even with specificity?"

19 MS. KRASAVTSEVA: Yes, we did. We asked for
20 questions to support numbers that they provided. They
21 provided a snapshot of the query report.

22 When we asked access to the work papers that
23 generate the report, so that we can see how that
24 snapshot was created -- right? -- because query is at
25 the control of the person running the query. So we

1 asked for access. We were not allowed that access.
2 Instead we were given an explanation, how that -- how
3 they came up with that query. So --

4 CHAIRPERSON COHEN: And so you're -- you are
5 rejecting the explanation and expressing a preference
6 for the actual data.

7 MS. KRASAVTSEVA: No. We explained that that
8 does not substantiate our request. So we -- we have
9 to -- what Audit's job is during the claim is to see
10 whether the taxpayer carried its burden. At the point
11 where Audit felt it reached a dead end, despite the
12 questions they asked, they were not really provided with
13 information on point.

14 At that point, Audit concluded that Taxpayer did
15 not meet its burden.

16 CHAIRPERSON COHEN: So then we remain basically
17 at an impasse. They are saying that they weren't asked,
18 and you are saying that they -- the Petitioner was
19 asked, and we don't have --

20 MS. KRASAVTSEVA: Well, the taxpayer -- the
21 taxpayer's -- the taxpayer's main argument in there is a
22 buyback agreement. We have not seen that. And that
23 would be the key evidence that would show, "Hey, we have
24 this structure where we buy back the cars at this
25 amount. Look."

1 CHAIRPERSON COHEN: And this information -- how
2 key is it to you for a determination?

3 MS. KRASAVTSEVA: I think that it is overall,
4 right? Because once that information is provided, it
5 may have additional clauses within the agreement that
6 raises more questions.

7 So I think you have to look at the situation, at
8 the structure, at the business, right? And what we have
9 seen from the financial statements, we have seen two
10 different transactions, and we have seen -- we don't
11 interpret the statement that Taxpayer interprets as it's
12 no sales. We interpret double earning on the same car.
13 First, as the wholesale sale of goods; and, second, as a
14 financial revenue. Taxpayer also finances cars. And it
15 claims that revenue separately.

16 So here, the only difference is that you finance
17 half of the car when you lease it, right? It is sort of
18 like a pseudo sale, pseudo financing, right?

19 So you don't own the full car, but you finance
20 half of the car; so you drive the car for a less amount
21 because you are only financing half of it. So it is
22 really similar to financing. And Taxpayer here is not
23 claiming that it's repurchasing the cars it finances.

24 CHAIRPERSON COHEN: Okay.

25 Something you wanted to add?

1 CHIEF COUNSEL BRUNETT: Yes. Thank you. Thank
2 you very much, Chair.

3 What I was mentioning, I was going to follow up
4 on your comment about an impasse and maybe that there's
5 more chance to look at documentation that Irina
6 mentioned.

7 So one option -- jumping ahead, one option for
8 your Board -- I know you guys have questions to get
9 through -- would be for your Board to potentially vote
10 to keep the hearing open in order to let the taxpayer
11 and Franchise Tax Board examine that evidence. I'm not
12 advising you one way or the other because that's not my
13 job in this particular instance, but that is one option,
14 that the hearing could be held open for another Board
15 meeting in the future. And for the parties to try to
16 work through that process. So I did just want to
17 mention that.

18 CHAIRPERSON COHEN: Okay. But I think also it's
19 important for us to mention that this item has been open
20 for two years; is that right? And so there probably
21 needs to be some form of closures.

22 CHIEF COUNSEL BRUNETT: The audit has been. The
23 petition for the alternative apportionment is -- was --
24 we did fast-track this when Legal and Audit got it to
25 the point where -- to hold the hearing. And then

1 when -- when Mr. Sperring filed the petition, then we
2 did, you know, get this on the earliest Board we
3 possibly could. So --

4 CHAIRPERSON COHEN: And what was the reason that
5 you fast-tracked it?

6 CHIEF COUNSEL BRUNETT: Because there was a --
7 well, I can say why we -- Jon, do you want to say why we
8 fast-tracked it? Or I will.

9 MR. SPERRING: Sure. Yeah. Yeah. No. I'm
10 happy to do that.

11 I guess the one thing was, we -- what month -- I
12 think it was in January that we requested this petition
13 before the Board, for the March meeting. We were told
14 that the Board couldn't move that quickly. And so then
15 I asked, "Well, can we please have it done at -- in
16 June?" And so that's what we were given, June.

17 I don't know why it would take from January to
18 September and why, basically, six months is considered
19 fast-tracking, instead of nine months.

20 I will let you take that, Jozel.

21 CHIEF COUNSEL BRUNETT: Sure. And I would be
22 happy to explain that.

23 What -- you know, there's briefing that goes on,
24 and Jon did offer to waive doing a reply brief. But we
25 also have accessibility rules to follow. And we have to

1 make all of the briefs that are in your binders and the
2 other presentations accessible, which takes some time.

3 So that's why, by the time I received the request
4 in January to hold it in March -- and, you know, there's
5 the ten-day notice, all of that, things that happen, we
6 weren't able to do that.

7 And we were also asked to fast-track it due to
8 the fact that I understand that Petitioner may be
9 changing counsel at the end of this month. They
10 regularly will rotate who their counsel are. So we did
11 everything we could to accommodate getting it done
12 before that occurred, and that's why we are here today.

13 CHAIRPERSON COHEN: All right. Understood.
14 Thank you.

15 Mr. Vazquez, I will let you finish your
16 questions.

17 MEMBER VAZQUEZ: Thank you.

18 Let me go back to -- this one is for the
19 Petitioner.

20 Could you kind of walk through -- me through this
21 transaction, whether there's actually one sale or two
22 sales that take place in this process.

23 MR. SPERRING: Sure. Sure.

24 So the first thing that happens -- right? -- is
25 before any car could go to the dealership -- okay? --

1 and there's -- it varies, but about 50 in California,
2 right? So one year, 48. The next, it went up to 50.

3 But before a car ends up on a dealership, the
4 dealership has to buy that car from Daimler -- all
5 right? -- and pay for it, right? So that -- that's the
6 first sale, if you will.

7 Then, if a consumer decides to lease the car --
8 right? -- at that point there -- and they say -- and
9 they have a choice, by the way. Consumer is allowed to
10 lease it from their own finance company or Daimler,
11 right?

12 And if they choose to lease it from Daimler, at
13 that point there, Daimler Mobility will buy the car back
14 as pursuant to the lease, right? To facilitate the
15 lease transaction.

16 So let me stop there.

17 Does that answer your question?

18 MEMBER VAZQUEZ: I think you are getting there.

19 MR. SPERRING: Okay.

20 MEMBER VAZQUEZ: Let me go back here to staff
21 here.

22 You mentioned -- I -- I'm -- in reading through
23 this, you are making a case that there's two sales,
24 right?

25 MS. KRASAVTSEVA: Correct.

1 MEMBER VAZQUEZ: Walk me through that because I
2 don't --

3 MS. KRASAVTSEVA: Yes.

4 MEMBER VAZQUEZ: -- understand where there's a
5 second sale.

6 MS. KRASAVTSEVA: The second sale --

7 MEMBER VAZQUEZ: Because you just finished saying
8 earlier that --

9 MS. KRASAVTSEVA: Sure.

10 MEMBER VAZQUEZ: -- you are not even buying it.
11 You are basically renting it because --

12 MS. KRASAVTSEVA: Well --

13 MEMBER VAZQUEZ: -- you are only -- and I think
14 our attorney said that you are only really leasing half
15 of this vehicle.

16 MS. KRASAVTSEVA: Well, if I own an apartment I
17 want to rent -- if I own an apartment that I don't need,
18 I can rent it or lease it. Whether I -- I'm sorry. I
19 can rent it or sell it.

20 If I sell it I have gross receipts. I have
21 income. That is a taxable transaction. If I rent it, I
22 have rent revenue. That is a taxable transaction.

23 So when a dealer leases a car, it sells right to
24 use the car during the lease period. So it is a sale
25 transaction. It is just a cheaper transaction for the

1 lessee, because the lessee only buys the right for half
2 of the car.

3 So it is a taxable transaction. And when the
4 dealer leases the car, it is a tax -- it is a
5 transaction with tax consequences. It is not just a
6 transfer of a car. It is a sale by lease.

7 And my understanding, based on what Taxpayer told
8 us in their briefs, is that all leases are assigned
9 automatically to Daimler.

10 So, you know, it's not like Taxpayer -- the
11 client has a option or anything like that. All leases
12 are sold to Daimler as a stream of payment. They are
13 sold to Daimler.

14 So Daimler buys leases. They don't just take it
15 back. They pay for it. And they pay for the leasing
16 services, whatever the cost that dealer incurred while
17 leasing the car. Daimler also doesn't know how many
18 cars would be leased, right?

19 I mean, there's no benchmarks or anything. So it
20 may be more cars; it may be less cars. It all depends
21 on the financial markets and the situation and the
22 dispensable income -- disposable income.

23 So it is two transactions. They both have tax
24 consequences. They both have revenue. And they both
25 come with expenses.

1 If you and I were deciding to participate in
2 income stream, we will have to pay for it, right? That
3 would be our reduction of the revenue from the income
4 stream. So their lease acquisition is simply buying in
5 to receive lease payments as a stream of revenue.

6 MEMBER VAZQUEZ: So if I'm following you --
7 correct? -- I guess, unlike me, the lessee, I never
8 really take ownership of this vehicle, whereas Daimlee
9 [sic] technically does on the first sale; is that
10 correct?

11 MS. KRASAVTSEVA: On the first -- the first sale
12 is when Daimler sells cars to the dealer. The second
13 sale is when the dealer leases car to the consumer.

14 MEMBER VAZQUEZ: But the dealer doesn't actually
15 lease the car to the -- I thought it was Daimlee that
16 actually leases the vehicle.

17 MS. KRASAVTSEVA: No. Daimler is prohibited from
18 leasing vehicles directly to consumers by California
19 law. It's the dealers who lease cars.

20 MEMBER VAZQUEZ: Oh -- so you are saying
21 technically it's the dealer even though -- because when
22 you go through this process, they always send you to
23 Daimlee to do -- to set up the lease. You are not going
24 through the dealership at that point.

25 MS. KRASAVTSEVA: I'm sorry. I don't drive

1 Mercedes; so I don't know how leases are done. But --

2 MEMBER VAZQUEZ: BMWs are the same; so...

3 MS. KRASAVTSEVA: But I don't own that either.

4 But -- and I have never leased.

5 But the lease agreement is very clear, and it is
6 an exhibit to our brief. The lease agreement between a
7 lessor, which is a dealer, not Daimler, and lessee,
8 which is a consumer.

9 And then there's a small portion in the lease
10 agreement that says that your agreement will be assigned
11 to Daimler Trust.

12 So the lease transaction happens between the
13 dealer and dealer's retail customer. Daimler is not
14 part of it.

15 Although Daimler might have already had an
16 agreement with dealer for the assignment, right? But it
17 makes sense that there is this agreement which we have
18 never seen for some reason.

19 MEMBER VAZQUEZ: Okay. Well, let me --

20 CHAIRPERSON COHEN: All right.

21 MEMBER VAZQUEZ: Go ahead.

22 CHAIRPERSON COHEN: All right. Thank you very
23 much. I have a couple of questions to FTB staff.

24 So forgive me if they are duplicative in nature,
25 but if anything they are just offering an opportunity

1 for more clarity.

2 MS. KRASAVTSEVA: No problem. No problem.

3 CHAIRPERSON COHEN: So do you consider MBUSA,
4 Daimler Trust, and Daimler Mobility to be part of a
5 unitary group?

6 MS. KRASAVTSEVA: Correct. They are part of a
7 unitary group, yes.

8 CHAIRPERSON COHEN: Okay. Okay.

9 And how do you address Daimler's argument that
10 under California's law, car manufacturers that make cars
11 sold by third-party dealerships, like the taxpayer, are
12 not permitted to sell or lease directly to consumers,
13 that the vehicles must be sold to the dealership first?

14 MS. KRASAVTSEVA: I'm sorry. You are asking
15 me --

16 CHAIRPERSON COHEN: So how do you address
17 Daimler's argument that, under California's law that
18 prohibits car manufacturers that make cars sold by a
19 third party, that they are not permitted to sell or
20 lease directly to consumers, right? I think you have
21 highlighted already when you were answering
22 Mr. Vazquez's question.

23 So my question is, is that how do you address the
24 argument that the vehicles must be sold to a dealership
25 first?

1 MS. KRASAVTSEVA: Okay. So let's say there was
2 no law; that the dealers --

3 CHAIRPERSON COHEN: Well, let me just back up for
4 a second.

5 So what you are saying is, is that it's the --
6 it's the law that requires it. That moves the -- moves
7 the vehicles -- that the vehicles must be sold to a
8 dealership first.

9 MS. KRASAVTSEVA: The law prohibits Daimler to
10 lease or rent directly --

11 CHAIRPERSON COHEN: Yes.

12 MS. KRASAVTSEVA: -- which requires an
13 intermediary. So the law assumes there will be an
14 intermediary, and dealers are those intermediaries that
15 buy and sell, and they have a lot, and they have
16 relationship and provide customer service.

17 CHAIRPERSON COHEN: Okay. So you have stated
18 that Daimler proposed alternative apportionment, that
19 the Daimler proposed alternative apportionment is
20 unreasonable.

21 And in the event that the Board sides with the
22 taxpayer's unfair apportionment argument, what would be
23 your reasonable alternative?

24 MS. KRASAVTSEVA: So during my presentation, I --

25 CHAIRPERSON COHEN: Yes.

1 MS. KRASAVTSEVA: -- tried -- I tried to explain
2 that there is a relationship between what contributes to
3 the apportionable pie --

4 CHAIRPERSON COHEN: Yes.

5 MS. KRASAVTSEVA: -- and the mathematical formula
6 that takes a ratio out of it, right?

7 So our problem with Taxpayer's alternative is
8 that it has this one-sided approach. We have not
9 accepted their premise that there is a resale. From our
10 end, the apportionable income was calculated correctly
11 because we see there's two different transactions,
12 right?

13 But if Taxpayer is here saying, "Listen, it's not
14 two transactions. It's really one. There's a return.
15 Here's their agreement," then we have a problem with the
16 calculation of the base.

17 Then hold on a second. Then you sort of reduce
18 your income too much because, you know, if you return
19 the car, there's really no income, right? But you
20 include it -- but you reduce that income by your cost of
21 goods sold of the cars.

22 So the problem we have with the taxpayer's car is
23 this "disalignment" of what -- the activities that
24 contribute to the revenue and expenses -- they treat
25 these two activities as very separate. Not as one,

1 right? They treat lease payments and lease acquisitions
2 as separate things that augment the pie, and they treat
3 sales of cars as a separate income-producing activity
4 that also, you know, inflates or reduces the
5 apportionable income pie.

6 But when they calculate the fraction of it, the
7 only ones to -- they only would like to use as a single
8 transaction, as if it was intercompany. So unitary
9 business principles that you alluded to -- right? --
10 intercompany transactions, if there was no dealer
11 involved, then there would be no tax consequences
12 between related party transactions because we have a
13 dealer involved in the middle. There's the two separate
14 tax consequences, transactions that actually contributes
15 to their apportionment and their factor.

16 CHAIRPERSON COHEN: Okay. I'm going to have
17 another question just to move on a little bit. It's a
18 little bit more of a global question.

19 And I was just -- does this case set a precedent?
20 I mean, is it changing the way business is being done?
21 The leasing, the buying, the selling of cars?

22 CHIEF COUNSEL BRUNETT: Good question. Thank
23 you. Thank you, Madam Chair.

24 This decision would, of course, affect this
25 particular taxpayer that's in front of you.

1 But in terms of it being binding, per se, it may
2 not be. However, there -- similarly situated taxpayers,
3 that have the same situation as Daimler here, could file
4 claims for refund, could file alternative apportionment
5 if you were to -- the Board were to rule in favor of the
6 taxpayer.

7 And on the alternative, there are other
8 automobile companies that aren't in the same situation,
9 where they don't have as many leases as we have in this
10 situation. So to apply it consistently, those
11 particular automotive companies may owe additional tax
12 if your Board were to rule in front of the taxpayer in
13 this case.

14 So this could have potentially -- right? -- and I
15 can't say for sure, but potentially could have an impact
16 on other taxpayers in terms of similar taxpayers filing
17 claims for refund, with the -- you know, perhaps similar
18 dollar amounts involved.

19 And then the smaller ones -- I won't mention
20 names -- but there's some other companies that don't do
21 as many leases. It could have a negative impact on
22 them.

23 CHAIRPERSON COHEN: Okay. And I believe the
24 apportionment formula -- did -- it changed in 2017? Is
25 that right?

1 MS. KRASAVTSEVA: The apportionment formula to
2 the single sales factor, do you mean?

3 CHAIRPERSON COHEN: Yes. Yes.

4 MS. KRASAVTSEVA: Well, it changed in '13. 2013.

5 CHAIRPERSON COHEN: It was in 2013. Okay.

6 Sorry. I misheard. Okay. I thought you said '17.

7 So what led to the change?

8 MS. KRASAVTSEVA: Do you mean why we now have
9 single sales factor instead of three-factor
10 apportionment formula?

11 CHAIRPERSON COHEN: Yes.

12 MS. KRASAVTSEVA: It's Proposition 39. The
13 taxpayers voted for it.

14 CHAIRPERSON COHEN: Okay. All right. I have
15 questions for the Petitioners.

16 So is it true that you refused FTB's auditor's
17 request?

18 MR. SPERRING: Absolutely not. And it's very --
19 you know, again, you see how -- that they lose the
20 specifics very quickly, right?

21 So the specific item that FTB has made great hay
22 of -- okay? -- where we didn't provide exactly which was
23 verbally requested, was the amount of sales that were
24 going to the California dealers. They asked if they
25 could enter Daimler's system -- okay? -- to see the

1 numbers.

2 We said, "Look it. To send you a link in the
3 Daimler system, that could create issues if there's any
4 movement in those numbers. We'll send you copies of
5 query reports. Is that okay?"

6 They came back, "Yes, that's okay."

7 So instead of having direct access to Daimler's
8 financials, we gave them query reports.

9 There is no IDR that requests -- and it was never
10 asked -- that requests the contractual link between
11 Daimler and its dealerships that says that it will
12 purchase the leased cars pursuant to a lease
13 transaction. Okay?

14 They didn't request that. The auditors were
15 satisfied because the financials made it so crystal
16 clear that they were buying it back. Okay?

17 The lawyers who love to look at contracts -- they
18 have asked that.

19 Now, to me, the key, million-dollar, you know,
20 moment here, was when Delinda admitted -- right? -- that
21 it doesn't matter -- okay? -- or -- and maybe that was
22 Irina. But they basically said, "It doesn't matter if
23 we see it. It's not going to be determinative." Okay?

24 They have made up their minds that alternative
25 apportionment is not warranted. Okay? But the bottom

1 line is, there's really no dispute of the underlying
2 facts here. I mean, there -- you know, there's an
3 argument over semantics --

4 CHAIRPERSON COHEN: Yeah.

5 MR. SPERRING: -- but there's no dispute under
6 the facts.

7 CHAIRPERSON COHEN: Okay. Okay.

8 Let me ask you something else: Do any of your
9 agreements contain a repurchase clause regarding car
10 dealers, where -- regarding car dealers --

11 MR. WHITNEY: There's not a --

12 CHAIRPERSON COHEN: -- were to lease -- were to
13 lease post-acquisition?

14 MR. WHITNEY: There -- there's not a contractual
15 requirement that we repurchase the car.

16 I did want to add to a few things that Jon said,
17 though. That if California law didn't require us to
18 sell to the dealer, and it allowed us to lease directly,
19 we wouldn't have this issue. We would have the
20 8 percent apportionment percentage.

21 CHAIRPERSON COHEN: No, I -- believe me --

22 MR. WHITNEY: Yeah.

23 CHAIRPERSON COHEN: -- I gather that.

24 MR. WHITNEY: Okay.

25 CHAIRPERSON COHEN: I -- who introduced this law

1 in 2013? Who carried that in the legislature? Do you
2 know?

3 MR. WHITNEY: Kevin de León.

4 CHAIRPERSON COHEN: Thank you, Kevin. All right.
5 Okay. Well, I -- we're going to move on.

6 I'm going to move on. I want to talk about the
7 repurchase argument that you guys are putting out there.
8 Okay?

9 So in your repurchase argument, you say that the
10 dealer assigns the lease to Daimler Trust, an affiliate
11 of MBFS.

12 I was wondering if you could elaborate on the
13 relationship between MBUSA, Daimler Financial Services,
14 Mercedes-Benz Financial Services, USA, LLC.

15 MR. WHITNEY: They are -- they are all unitary
16 members of a single unitary business. They work --

17 CHAIRPERSON COHEN: Okay.

18 MR. WHITNEY: -- together to generate profit.
19 It's just that on the wholesale sales that we buy back,
20 we don't generate any economic profit because the dealer
21 is not going to sell it for a penny less than what they
22 bought it for.

23 But overall, yes, it's a unitary business. We
24 have to file together and apportion the profit.

25 CHAIRPERSON COHEN: Okay. Prior to 2013, was

1 there this level of confusion?

2 MR. WHITNEY: Prior to 2013, we would have had
3 the property and payroll factor that would have given --
4 reflect to the manufacturing activity and the
5 headquarters and everything outside the state. We no
6 longer have that.

7 If we did have that, it would probably ameliorate
8 some of the effect of this distortion here in terms of
9 the stark impact on the apportionment percentage.

10 We're not here arguing to resurrect the property
11 and the payroll factor, you know, and why.

12 CHAIRPERSON COHEN: I understand.

13 MR. WHITNEY: It is what it is.

14 CHAIRPERSON COHEN: I'm just asking you a
15 question and your opinion.

16 MR. WHITNEY: Yes.

17 CHAIRPERSON COHEN: You've been giving your
18 opinions all morning. Don't stop now. I want to hear
19 what your opinion is.

20 But we can move on. I have one more question for
21 you guys.

22 And that's if MBUSA is not a party to the lease
23 agreement, isn't it true that the assignment of leases
24 is not -- is actually not a repurchase but an
25 acquisition in its own right?

1 MR. WHITNEY: I mean, I think it's a fair point.
2 It is a separate legal entity that purchases the lease
3 property back. But, again, if it's one unitary
4 business, I go back to my example of left hand, right
5 hand. That I'm selling to a dealer with one hand; but
6 as part of the same unitary body, if you will, the right
7 hand is purchasing it back.

8 I call that a repurchase within the context of a
9 combined reporting group and a unitary business.

10 But it is a separate entity that purchases the
11 leased assets back.

12 CHAIRPERSON COHEN: Okay. All right. I'm going
13 to turn to my colleague online.

14 Ms. Gonzalez, I was wondering if you had any
15 questions or would like to participate in the
16 conversation?

17 MEMBER GONZALEZ: Yes, thank you.

18 I do want to say it sounds like this is a very --
19 well, there's a difference of opinion for sure. Very
20 clear of that.

21 And there is through, you know, State law --
22 these are heard by the Office of Tax Appeals with a
23 panel of tax experts, which seems like that would be
24 appropriate here.

25 I also wanted to make sure that I heard this

1 correctly earlier. It sounds like there may be some
2 additional information that could be analyzed, that may
3 be helpful.

4 And did I hear someone say that there is a
5 process where FTB could take some additional time if
6 there is additional documentation to review? Was that
7 correct?

8 CHIEF COUNSEL BRUNETT: Yes. Thank you, Deputy
9 Gonzalez.

10 Yes. There is -- there is that process, that if
11 the Board were to rule to hold the matter open, that we
12 could do that.

13 And you mentioned Office of Tax Appeals as an
14 alternative remedy. The taxpayers have filed with the
15 Office of Tax Appeals, and that case is currently
16 pending.

17 MEMBER GONZALEZ: Okay. Great.

18 Thank you. That's all I had.

19 CHAIRPERSON COHEN: And you said the case is
20 currently pending.

21 But do we have a time or a date?

22 CHIEF COUNSEL BRUNETT: No. It's -- it actually
23 was filed before the petition was filed in this case to
24 your Board. So it was filed. And then the petition was
25 filed. And so it's right now, according to what we

1 have -- our procedures, what we will usually do is
2 Office of Tax Appeals will defer it pending -- pending
3 your Board, as long as the taxpayer has the petition.

4 You know, if they were to withdraw it or
5 something -- I'm not saying they would -- then the --
6 then the OTA would go forward. But they are in front of
7 the OTA right now.

8 CHAIRPERSON COHEN: Okay. Well, that -- that
9 doesn't sway me one way or the other. That's good to
10 know.

11 CHIEF COUNSEL BRUNETT: No. Then that --

12 CHAIRPERSON COHEN: But I -- I'm actually
13 prepared --

14 CHIEF COUNSEL BRUNETT: Exactly.

15 CHAIRPERSON COHEN: -- to make a decision today.

16 CHIEF COUNSEL BRUNETT: Right.

17 CHAIRPERSON COHEN: I don't know if you -- if
18 there's any more -- may I ask one more question.

19 Do we need to take public comment on this
20 hearing?

21 (No response.)

22 CHAIRPERSON COHEN: No. Thank you.

23 MEMBER VAZQUEZ: Madam Chair, I would like to ask
24 if there's a willingness here, from at least us here,
25 present today, to postpone this matter and refer it back

1 to FTB to further do the audit? Because it sounds like
2 they are open to it, and it sounds like they have some
3 information here that hopefully could come up with a
4 resolution or some kind of compromise.

5 And I would like to see that if that's -- if
6 there's support for that.

7 CHAIRPERSON COHEN: Well, that's interesting.
8 Because I heard probably the exact opposite.

9 MEMBER VAZQUEZ: Oh, I'm sorry.

10 CHAIRPERSON COHEN: I heard that, yes, that is a
11 pathway forward but that I think resolution to this
12 matter today is probably in the best interest of not
13 only the Franchise Tax Board but also the taxpayer.

14 And I am not convinced that more time and more
15 information will lead to a resolution. I think that
16 there is definitely two separate interpretations, and we
17 have a responsibility, I guess, to opine on it.

18 MEMBER VAZQUEZ: I agree.

19 MEMBER GONZALEZ: Madam Chair, I would like to
20 second -- I would like to second Member Vazquez's ruling
21 to hold it open. I would like to second that.

22 MEMBER VAZQUEZ: I appreciate it, only because,
23 Madam Chair, is that I don't feel comfortable. If you
24 were to move -- for example, let's say you made a motion
25 to decide one way or the other, I would have to abstain,

1 and I just didn't want to abstain. I would rather make
2 a decision one way or the other, but I don't feel I have
3 all the information.

4 And then in listening to both sides, it sounds
5 like there is information that is lacking, especially on
6 this audit piece.

7 And then hearing from our attorney, it sounds
8 like they might be able to resolve this -- or at least
9 come up with some recommendations. And then at that
10 point I have no problem making the decision if that's
11 okay with the Chair, Madam Chair.

12 CHAIRPERSON COHEN: Okay. So...

13 MEMBER VAZQUEZ: And I don't know if you could
14 expedite this because I don't know if -- like -- because
15 we only meet every -- what? -- three months.

16 I don't know if there's -- is there something
17 holding us from having something sooner on this?

18 CHAIRPERSON COHEN: That's a good question.

19 Can we have a special -- can we schedule a
20 special meeting?

21 MR. HOFELING: So right now there's nothing
22 scheduled, so the next one would be in September.
23 However, your Board can always schedule a special
24 meeting.

25 MEMBER VAZQUEZ: You know, if we could do that.

1 CHAIRPERSON COHEN: Okay. Okay. I guess --

2 MEMBER VAZQUEZ: I don't know how much time they
3 need to gather this and know --

4 CHAIRPERSON COHEN: Well, let's ask.

5 How much -- or maybe I don't know. I'm not quite
6 sure who to direct my question to.

7 CHIEF COUNSEL BRUNETT: It -- it's okay. It
8 would depend, of course, upon the taxpayer providing --
9 when we -- we would send questions, and we can work up
10 those really quickly on what we need. And then give the
11 taxpayer time to -- I would say, 30 days -- right? -- to
12 respond, to be reasonable, to provide that information
13 to us, and then we would take a look at it. So two
14 months? Which would be sooner than three.

15 MEMBER VAZQUEZ: I'm good with that. Whatever --

16 CHIEF COUNSEL BRUNETT: Well, we need -- we --
17 it -- it's important for all of us -- right? -- to get
18 the information to look at it. And so --

19 MEMBER VAZQUEZ: In a timely manner. I get it.

20 CHIEF COUNSEL BRUNETT: Right.

21 MR. HOFELING: And since it will be in open
22 session, we will have to still comply with Bagley-Keene
23 about proper noticing.

24 MEMBER VAZQUEZ: Notices and all that.

25 CHAIRPERSON COHEN: I don't necessarily think

1 that we need 60 days.

2 What if we were to come --

3 MEMBER VAZQUEZ: 45.

4 CHAIRPERSON COHEN: Yeah -- come to 45 in terms
5 of -- I mean, the noticing, that's -- we know how to do
6 that. That's easy.

7 Submitting the questions, we have already pretty
8 much discussed the -- there's one point of issue when
9 it -- for clarification on, I guess, a request of an IDR
10 from the auditor.

11 And then I would also ask that the auditor be
12 present for the -- for the next hearing --

13 CHIEF COUNSEL BRUNETT: We can do that.

14 CHAIRPERSON COHEN: -- and be --

15 MEMBER VAZQUEZ: Yeah.

16 CHAIRPERSON COHEN: -- and be available to answer
17 questions.

18 Okay. So it sounds like the motion is to
19 continue this item for 45 days.

20 MEMBER VAZQUEZ: Yes.

21 And allow for the audit to take place, both --

22 CHAIRPERSON COHEN: Well --

23 MEMBER VAZQUEZ: I'm sorry?

24 CHAIRPERSON COHEN: I don't want to interrupt
25 you. I'm sorry. Go ahead.

1 MEMBER VAZQUEZ: And you gave it the title. I --
2 and I guess it has a name for this.

3 What did you call it?

4 CHAIRPERSON COHEN: Oh, an IDR.

5 MEMBER VAZQUEZ: IDR. Yeah.

6 CHAIRPERSON COHEN: So there is -- there is --
7 and it sounds like there is just one point, but let --
8 May I restate the motion?

9 MEMBER VAZQUEZ: Sure. Go ahead.

10 CHAIRPERSON COHEN: So the motion is, is that we
11 continue this item to be heard in 45 days. Can you tell
12 me when exactly 45 days will be? Just so we can get a
13 feel.

14 CHIEF COUNSEL BRUNETT: Shane is going to
15 calculate it for us.

16 CHAIRPERSON COHEN: Shane. Okay.

17 No pressure, Shane, but don't make a mistake.

18 Just give me the week in July or -- yeah.

19 MEMBER VAZQUEZ: That would probably be August.

20 MR. HOFELING: It would be August 10th.

21 CHAIRPERSON COHEN: The week in August 10th.

22 Okay. So...

23 MEMBER VAZQUEZ: That's a Thursday.

24 How does that work?

25 CHAIRPERSON COHEN: Not for me.

1 MEMBER VAZQUEZ: No? Do you want to do it before
2 or after?

3 CHAIRPERSON COHEN: Well, we're going to have to
4 do it before. I'm sorry. I'm not going to be available
5 the second week of August. I'm going to be --

6 MEMBER VAZQUEZ: How about the first week of
7 August?

8 CHAIRPERSON COHEN: Just give me one minute,
9 please.

10 MEMBER VAZQUEZ: Oh, shoot. I'm not around the
11 first of the month, now that I'm looking at my schedule.
12 How about the third week?

13 CHIEF COUNSEL BRUNETT: Speaking on -- probably
14 not -- I don't want to speak on behalf of Jon and Chris,
15 but we do need to give them time to respond as well --
16 right? -- and within that time period.

17 So we can get the questions done by the end of
18 this week and get them over there. I just don't know
19 how much -- I will let you guys speak for yourselves how
20 much time you need.

21 MR. SPERRING: Yeah. I mean, we will be
22 flexible. But if the third week of August works, maybe
23 that's the best way to go.

24 CHAIRPERSON COHEN: Okay. Third week of August.
25 Which is one week before our scheduled --

1 MEMBER VAZQUEZ: No. We're in September.

2 CHAIRPERSON COHEN: Oh, that's right. Okay.

3 So the third week of August --

4 MEMBER VAZQUEZ: The week of the 14th.

5 CHAIRPERSON COHEN: -- we will -- we will -- we
6 will reconvene and address this matter.

7 So I guess what we are going to do is just make a
8 motion to table this item till the next specially -- the
9 next special meeting.

10 Is that the correct motion?

11 MR. HOFELING: Yeah. So we will need two
12 motions: one to do that, and then one to hold the
13 special meeting.

14 CHAIRPERSON COHEN: One more time. What did you
15 say, Mr. Hofeling?

16 MR. HOFELING: Yeah. We'll need to do two
17 separate motions: one to hold this meeting over, and
18 then a second motion to schedule a special meeting.

19 CHAIRPERSON COHEN: All right.

20 All right. I will make a motion to hold this
21 item open -- to hold this item over.

22 Is there a second?

23 MEMBER VAZQUEZ: Second.

24 CHAIRPERSON COHEN: Second by Vazquez.

25 Let's take a vote.

1 Oh, excuse me. Do we -- do we need to take
2 public comment on this motion?

3 MR. HOFELING: I'm sorry?

4 CHAIRPERSON COHEN: Do we need to take public
5 comment on this motion to hold this open?

6 MR. HOFELING: No.

7 CHAIRPERSON COHEN: Okay. Thank you.

8 Please call the roll.

9 MS. RUBALCAVA: Member Vazquez.

10 MEMBER VAZQUEZ: Aye.

11 MS. RUBALCAVA: Deputy Member Gonzalez.

12 MEMBER GONZALEZ: Aye.

13 MS. RUBALCAVA: Chair-Controller Malia Cohen.

14 CHAIRPERSON COHEN: Aye.

15 And -- thank you.

16 The second motion we will be making is to
17 schedule a special meeting --

18 MEMBER VAZQUEZ: A special meeting.

19 CHAIRPERSON COHEN: -- in August, third week.

20 MEMBER VAZQUEZ: Third week of August.

21 So just move -- move it?

22 CHAIRPERSON COHEN: I need a second.

23 MEMBER VAZQUEZ: I will second.

24 CHAIRPERSON COHEN: All right. Thank you.

25 The motion has been made and seconded.

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Please call the roll.

MS. RUBALCAVA: Member Vazquez.

MEMBER VAZQUEZ: Aye.

MS. RUBALCAVA: Deputy Member Gonzalez.

MEMBER GONZALEZ: Aye.

MS. RUBALCAVA: Chair-Controller Malia Cohen.

CHAIRPERSON COHEN: All right. Thank you. Aye.

All right. We are going to keep moving on. I think this concludes our FTB meeting. I will see you all for Part 2, third week of August.

Thank you. We are adjourned.

(Proceedings concluded at 1:30 p.m.)

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CERTIFICATE OF REPORTER

I, KATHRYN S. SWANK, a Certified Shorthand Reporter of the State of California, do hereby certify:

That I am a disinterested person herein; that the foregoing proceedings were reported in shorthand by me, Kathryn S. Swank, a Certified Shorthand Reporter of the State of California, and thereafter transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said proceedings nor in any way interested in the outcome of said proceedings.

IN WITNESS WHEREOF, I have hereunto set my hand this 28th day of July 2023.

/s/ Kathryn S. Swank
KATHRYN S. SWANK, CSR
Certified Shorthand Reporter
License No. 13061

