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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
APPEARANCES CONTINUED

STAFF CONTINUED

ROGER LACKEY

DELINDA TAMAGNI

---o0o---

ALSO PRESENT

WINDIE SCOTT, State Controller's Office

JON SPERRING, PricewaterhouseCoopers

CHRIS WHITNEY, PricewaterhouseCoopers

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

My name is Malia Cohen. I am the Chair of the Franchise Tax Board, and I want to welcome you today. It's good to see you, to my left, Mr. Vazquez.

MEMBER VAZQUEZ: Good morning.

CHAIRPERSON COHEN: Good morning to you.

Good morning to you, Hasib Emran.

MR. EMRAN: Good morning.

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

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

MS. RUBALCAVA: Member Vazquez.

MEMBER VAZQUEZ: Present.

MS. RUBALCAVA: Deputy Member Gonzalez.

CHAIRPERSON COHEN: Deputy Member Gonzalez.

(No response.)

CHAIRPERSON COHEN: Not here.
Next.

MS. RUBALCAVA: And Chair-Controller Malia Cohen.

CHAIRPERSON COHEN: All right. Thank you.

Is there anyone online?

Is that you, Ms. Miller?

(No response.)

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

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

(Pledge of Allegiance was recited in unison.)

CHAIRPERSON COHEN: All right. Thank you very much.

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

And for today's meeting, members of the public who wish to comment via teleconference, please call (877) 226-8189. And enter the access code of 6426797.
And please be aware that there is a short delay between the Web and the live stream and the live event.

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

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

Members, do you have any comments or any questions?

(No response.)

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

(No response.)

CHAIRPERSON COHEN: Okay. Seeing none --

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

(No response.)

PHONE MODERATOR: No members of the public are queuing up at this time.
Please continue.

CHAIRPERSON COHEN: All right. Thank you.

Do I have a motion for approval of the minutes?

MEMBER VAZQUEZ: So moved.

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

Is there a second?

Erica Gonzalez, are you on the line?

(No response.)

CHAIRPERSON COHEN: All right. Ms. Brunett.

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

CHAIRPERSON COHEN: Sure.

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

Thank you.

CHAIRPERSON COHEN: No problem. All right.

I will second that motion.

Mr. Vazquez, thank you very much.

Could you please call the roll?

MS. RUBALCAVA: Member Vazquez.

MEMBER VAZQUEZ: Aye.

MS. RUBALCAVA: Deputy Member Gonzalez.

(No response.)
Thank you very much. This matter passes.

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

Good morning. The floor is yours.

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

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

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

While FTB has informal recognition programs throughout the year, I am here to talk about four of our formal Employee and Supervisor Recognition programs that celebrate those who bring their best.
The Superior and Sustained Superior Accomplishment Awards recognize individuals and teams who make significant contributions to state government through exceptional job performance.

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

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

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

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

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

The individuals and teams you will see through the following slides have directly contributed to that excellence. They showed up, participated, and led FTB to great success.
These three award programs recognize specific groups of FTB employees for their hard work, dedication, and successful contributions of part of teams, large and small.

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

(Video presentation.)

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

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

CHAIRPERSON COHEN: Thank you very much.

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

MEMBER VAZQUEZ: Just comments.

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

I know, having worked in a government position myself in the past, sometimes it's a very thankless job. But to see that you are being recognized today, I think it just shows the importance of it. But also to thank
your families. Because I know in many cases, especially those that are heading up departments and are doing above and beyond the call of duty, that means you are taking away time from your families.

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

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

(Laughter.)

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

But once again, thank you for your service.

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

So it's my understanding that many of the award recipients are either in the audience today or they are
online, listening. I just want to personally thank you for your service and your commitment for being the recipient of one of these very important awards.

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

(Applause.)

CHAIRPERSON COHEN: Thank you very much.

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

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

All right. Thank you.

We can go to the next item.

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

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

If appropriate, we will return to the September Board meeting with fully developed proposals for your
approval. For the fiscal year '24-'25, we have identified seven concepts for development.

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

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

(No response.)

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

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

(No response.)

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

Please continue.

CHAIRPERSON COHEN: All right. Thank you very much. Okay, Jessica.
MS. BARTON: Okay.

CHAIRPERSON COHEN: Thank you.

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

CHAIRPERSON COHEN: Yes.

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

CHAIRPERSON COHEN: Jennifer --

MS. BARTON: -- Project.

CHAIRPERSON COHEN: -- sorry.

MS. BARTON: That's okay. It starts with a J.

I'm good.

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

The current phase, EDR2, builds on this platform by delivering enterprise case management and modeling services for audit, filing enforcement, and underpayment, as well as expanding on the taxpayer folder and Contact Center platform's functionality. This concept will address the resources required for the
fourth year of planning, design, consulting, and professional services that are critical to the success of the EDR project.

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

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

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

The fifth concept is for the disaster recovery site network refresh. This proposal requests funding to refresh IT network infrastructure components in FTB's
alternate storage site. The alternative storage site allows FTB to continue providing critical services in the event of a disaster impacting FTB's primary data center.

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

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

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

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

CHAIRPERSON COHEN: All right. Thank you. Colleagues, this is an informational item. Let's see. Do you have any questions? All right. Mr. Vazquez.
MEMBER VAZQUEZ: Just one quick one.

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

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

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

MS. BARTON: That's a great question.

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

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

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

MEMBER VAZQUEZ: Thank you.

CHAIRPERSON COHEN: All right. Thank you.

Let's go ahead and take public comment. If there's any member of the public that would like to comment on this item, please come up.
(No response.)

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

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

(No response.)

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

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

Good morning, Michael.

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

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

CHAIRPERSON COHEN: Oh, okay.

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

CHAIRPERSON COHEN: Ms. Gonzalez, are you online?

(No response.)

CHAIRPERSON COHEN: She can hear us, but we can't hear her.
MR. BANUELOS: Okay.

CHAIRPERSON COHEN: Okay. Thank you.

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

CHAIRPERSON COHEN: We'll keep trying.

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

This request pertains to our Van Nuys field office. Our existing lease at the Van Nuys field facility is set to expire on June 30th of 2023. Unfortunately, the Department of General Services recently informed us that the lessor will not grant a long-term extension to our lease in that facility.

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

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

At this time I'm requesting your approval to submit this request to DGS, and we would be happy to
answer any questions you may have.

CHAIRPERSON COHEN: Thank you.

Let me check with my resident Southern Californian.

Any comments?

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

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

I don't know how much space you need, but they have, like, I know, reps from the Assembly and the City Council and the Senate office for that area currently in that State building. So you might want to take a look at that. Because I know you are looking at this expiration right around the corner, and that might help expedite it for you.
The other issue I was just wondering, in this transition, I know you mentioned that this is not a facility that you allow people to just walk in. It's more of just for audits. It's more for staffing, for them to do their work.

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

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

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

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

MEMBER VAZQUEZ: Okay.
CHAIRPERSON COHEN: All right. No other questions?

MEMBER VAZQUEZ: I'm good.

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

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

MEMBER GONZALEZ: Can you hear me?

CHAIRPERSON COHEN: Yes.

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

CHAIRPERSON COHEN: No problem.

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

MEMBER GONZALEZ: No. Thank you.


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

Is there any comment?

(No response.)

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

PHONE MODERATOR: Members of the public on the phone lines, if you would like to place yourself in the queue for public comment, as a reminder, you may press 1, then 0, at this time.
PHONE MODERATOR: No members of the public are queuing up at this time.

Please continue.

CHAIRPERSON COHEN: All right. Thank you very much.

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

Is there a second?

MEMBER VAZQUEZ: Second.

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

Let's 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: Aye.

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

MR. BANUELOS: Thank you.

CHAIRPERSON COHEN: Item 4 is on the Executive
Officer's time.

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

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

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

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

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

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

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

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

So as mentioned at the March meeting, the taxpayers and businesses in most counties in California can postpone the filing of their 2022 tax returns and payments to October 16, 2023.
Even with this extension in place, as of right now, we have processed 16.6 million personal income tax returns, with 93.3 percent of those e-filed.

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

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

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

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

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

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

So for those taxpayers that have not yet activated their debit cards, FTB and Money Network sent
reminder letters to each individual reminding them of the value of the MCTR Program and how to activate their cards.

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

Thank you, Board Members, for your time.

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

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

EXECUTIVE OFFICER STANISLAUS: E-file.

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

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

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

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

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

EXECUTIVE OFFICER STANISLAUS: Yes. It's between
1 and 2 percent at this point in time, but we'll have the numbers October 16th.

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

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

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

EXECUTIVE OFFICER STANISLAUS: Yes.

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

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

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

CHAIRPERSON COHEN: All right. Please.

MEMBER VAZQUEZ: Well, first of all, just thank you for your presentation, Selvi. I look forward to hearing, though, the updates in the coming -- in the
fall, that I guess we will have the final numbers that we're looking at, and just seeing if the postponement to the Middle Class Tax Refund helped people file their returns on time.

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

Thanks.

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

Let me just pivot to my colleague online.

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

MEMBER GONZALEZ: No, thank you, Madam Chair.

CHAIRPERSON COHEN: All right. Thank you.

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

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

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

(No response.)

CHAIRPERSON COHEN: All right. Seeing none, let's go to those that are online.
PHONE MODERATOR: Members of the public on the phone lines, if you would like to place yourself in queue for public comment, as a reminder, you may press 1, then 0, at this time.

(No response.)

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

Please continue.

CHAIRPERSON COHEN: All right. Thank you.

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

MEMBER VAZQUEZ: Yes.

CHAIRPERSON COHEN: Please.

MEMBER VAZQUEZ: Thank you, Madam Chair.

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

But I'm just putting it out there again, hoping that this will come back. I'm not sure in what format.
But just interested. Because having gone to a couple of these in the past and even some of the resource fairs I've participated even during COVID and after COVID with my County Assessor, they are so valuable for folks, especially for those that don't have the resources or the -- really the know-how, how to navigate the system, to make sure they are getting the most and hopefully the best advice as they are filing their taxes as well.

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

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

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

MR. HOFELING: Yes, Member.

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

MEMBER VAZQUEZ: And then I notice there's
another one with Senate Bill, I guess it's 565, with
Ms. Caballero, would require FTB to provide a free
online tax return preparation protocol, the CalFile, to
qualify individuals, that is individuals who would
qualify for Cal, I guess it's EITC, for taxable years on
and after January 1 of 2025.

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

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

MR. ARMSTRONG: Thank you, Shane.

And thank you for your question, Board Member
Vazquez.

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

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

In our published analysis -- and I would be happy
to provide a copy for you at the end of this -- we have
looked at potentially, for the first year, for the 2025
tax year, about 140,000 taxpayers will be impacted by
this.

    For the '26 tax year, 420,000.
    And then for the '27 tax year, 549,000.
    MEMBER VAZQUEZ: And I thank you. I appreciate
    it.
    And I guess, along those lines, has FTB taken a
    position on SB 565? Do you know?
    MR. HOFELING: No. FTB traditionally doesn't
take a position on any bill unless the three-member
Board, your Board, chooses to take an official position.
Otherwise, we remain neutral on all bills. The only
exception is if it is a bill that -- or was a
legislative proposal that was approved by your Board.
    MEMBER VAZQUEZ: So then I guess I have two
follow-ups. So one would be -- and it sounds like, in
the analysis, I guess that you had mentioned, does
that -- is that favorable to SB 565?
    MR. ARMSTRONG: When you say -- when you say,
"favorable," so our analysis would be from a technical
perspective.
    MEMBER VAZQUEZ: It wouldn't be whether you
support or --
    MR. ARMSTRONG: Correct.
As Mr. Hofeling mentioned, we --

MEMBER VAZQUEZ: Okay.

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

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

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

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

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

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

So we are more enforcing the laws than
necessarily opining or our opinion in -- or, in this
case, blessing.

                   Does that sound right?
MR. HOFELING: Yes.

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

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

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

MEMBER VAZQUEZ: Okay. Just putting it out
there.

CHAIRPERSON COHEN: I appreciate it.

MEMBER VAZQUEZ: Thank you.

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

EXECUTIVE OFFICER STANISLAUS: No.

CHAIRPERSON COHEN: No? Okay.

EXECUTIVE OFFICER STANISLAUS: So that is
correct.

But Board Member Vazquez, you are free to, you
know, send your left of support individually of course.
MEMBER VAZQUEZ: Not a problem. Thank you.

CHAIRPERSON COHEN: Thank you very much.

All right. Thank you.

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

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

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

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

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

If you could just stand up and wave just so
people can see who you are.

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

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

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

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

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

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

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

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

    Thank you for the reminder.
Any member of the public that's in the chambers today that would like to comment on any items today?

(No response.)

CHAIRPERSON COHEN: None? Okay.

We will go to public comment online.

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

(No response.)

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

Please continue.

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

(Break taken in proceedings: 11:28 a.m. to 11:45 a.m.)

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

Thank you.

Do we have Member Gonzalez with us online?

(No response.)

CHAIRPERSON COHEN: I will trust that she's on.
EXECUTIVE OFFICER STANISLAUS: Yes, we do.

CHAIRPERSON COHEN: Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

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

And so this double counting produces an unfair result because the leasing activity in California occurs disproportionately relative to the sale of vehicles outside the state.
Fortunately, there's a very simple solution. Your Board may grant an adjustment to the standard apportionment formula to simply exclude the double-counted unwound sales that don't produce any economic profit. Doing this will leave the leasing receipts that produce the profit in the apportionment formula. It will have no effect on taxable income. It will be fair, reasonable, and fully consistent with adjustments that the FTB staff has made for decades to the standard formula.

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

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

We're not here to discuss that because the IRS and FTB Audit Staff have already reviewed total income, and they have confirmed that amount.
We're here really to look at the middle, which is the apportionment formula, and to look at fair apportionment of the overall income.

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

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

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

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

The basic investment pool, that cash, was being
double counted, over and over and over again, really producing very little or no economic profit along the way. And the FTB pointed to that and said that this out-of-state activity was inflating the sales factor denominator. It was double counting results. It didn't produce any income. And it should be removed from the formula.

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

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

Now, this is the way the standard apportionment formula should and most often does work. If you sell 10 percent of your product in California, as you would expect, you would have a 10 percent apportionment
factor. You would apply that to your income and pay tax on 10 percent of your taxable income. That would be logical, it would be consistent with what you would expect.

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

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

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

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

I'm going to turn it over to my partner, Jon, who is going to talk about Daimler's specific facts in
greater detail and also the remedy.

MR. SPERRING: Thank you, Chris.

Good morning, Madam Chair, and Honorable Board Members.

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

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

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

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

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

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

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

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

Failure to treat the unwound sale as a single return transaction conflicts with unitary taxation and leads to double counting in the apportionment of leased
Looking at the entire unitary business as opposed to discrete subsidiaries within a corporate enterprise is the linchpin of "apportionability," as the U.S. Supreme Court so eloquently stated in Mobil Oil.

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

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

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

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

By double counting leasing activities that is
heavily weighted to California, while counting
out-of-state truck and bus sales only once, the standard
formula apportionment fails to reflect Daimler's
California activities.

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

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

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

CHAIRPERSON COHEN: Thank you very much.

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

My name is Irina Iskander Krasavtseva. And to
simplify communication a bit, I will go by Irina
Iskander. I'm a Tax Counsel IV at the Multistate Tax
Bureau in the FTB's Legal Division. With me is my
Assistant Chief Counsel, Delinda Tamagni.
Over the next 30 minutes, we will briefly cover applicable legal framework and illustrate how it applies to the taxpayer's situation in this case.

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

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

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

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

As Taxpayer did not carry its burden of proving otherwise, it is not entitled to the $38 million in refunds it is seeking pursuant to its Section 25137 Petition.
Let's talk about apportionment.

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

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

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

Fair apportionment is about fair factor representation.

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

And states also have wide latitude to fashion a formula used to -- for approximating the in-state
portion or the slice of the total volume that the
business enterprise produces through its multistate
business activities.

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

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

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

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

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

We do that by a formula, which in our simple
example, factors in gross receipts from selling cars in
If Taxpayer sold 100 cars in total for $100 each, and 20 of those cars were sold in California, we would assign 20 percent of Taxpayer's total apportionable income to California.

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

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

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

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

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

These rules also require that a party invoking
Section 25137 carries the burden of proving, by clear and convincing evidence, first, that the approximation provided by the standard formula is not a fair representation; and, second, that the party's proposed alternative is reasonable.

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

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

About six years later, California Court of Appeals in General Mills decision, also agreed with FTB that factor representation by reference to the gross receipts from the General Mills hedging activity, which was not conducted for its own profit, but which generated 30 percent of total gross receipts, while at most 2 percent of total income, was unfair. To remedy
the unfairness, the Court invoked Section 25137.

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

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

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

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

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

On the left, you can see Taxpayer's Industrial Business Unit, with MBUSA LLC selling Taxpayer's cars to unrelated U.S. dealers in the wholesale car market.
On the right, we have another, Financial Services Business Unit, which earns separate stream of incomes from providing financing and financial services.

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

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

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

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

According to Taxpayer's Annual Reports, which we included with our opening brief as Exhibit F, the Industrial Business Unit car sales to dealers generated a rate of return on sales of about 9.4 and 7.8 percent
in 2017 and 2018, respectively.

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

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

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

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

This way, the activity that contributes to the
total pie is also ratably factor represented in the
formula that determines California's slice of the pie.

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

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

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

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

Note that all lease-related transactions are
separate and subsequent to the original sale transaction
between dealers and the Industrial Business Unit. While Taxpayer asserts here that it repurchases cars just before leases are extended, this is not possible because California law prohibits Daimler from leasing its cars directly to consumers. In reality, therefore, titles to the leased cars pass to the Trust only as a consequence of its independent purchasing of the right to receive a stream of lease payments from dealer -- from the dealer's customers.

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

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

This is double earning, and the standard formula
accounts for these distinct, unrelated to each other business activities by fairly factor representing each activity separately.

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

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

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

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

As noted within the transaction chart on the left
of the slide, MBFS received cash from the sale of the
note to the underwriters. A bubble on the right also
explains that the underwriting involves a sale and a
purchase of the notes. A sale is not a loan; a sale to
third parties does generate gross receipts.

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

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

In that case, the Idaho State Court agreed with
Idaho State Tax Commissioner that inclusions of account
receivables under the accrual method and inclusion of
cash receipts from the sale of the same accounts
receivables under the cash method was akin to double counting of the same receipts, finding such double inclusion distortive.

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

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

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

Let's quickly summarize.

Overall, facts do not support a repurchase transaction or double counting of gross receipts takes place. One unit's car sales to dealers and another unit's lease acquisition are two completely separate and unlinked to each other, regular business transactions. MBUSA did not contract to repurchase leased cars. In fact, it did not repurchase cars.
Financial Services Business is not in the business of buying cars. Instead, it owns titles to cars, merely as a consequence of lease assignment and as the requirement for issuing auto-lease asset-backed securities which it sells for cash.

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

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

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

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

Overall, car sales to dealers and lease payments from dealers' clients were two independent business
transactions with unrelated parties. Each activity was part of Taxpayer's main business, and each was entered into for profit.

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

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

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

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

On average, these two activities together generated about 19 percent of its total apportionable business income in California. Again, 19 percent is the cumulative extent of Taxpayer's activities in the state when you consider sale of cars to Client 1 and lease payments received from Client 2.
In turn, standard apportionment formula sources only 13 percent of these activities to California. As you can see, standard rules do not over source to California the taxpayer's income from these transactions, 19 percent of which are in California. In fact, the standard apportionment factor appears to under source it.

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

Can you do Slide 16, please? -- as well as to revenue and expenses --

The pie. Thank you.

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

Yes. No. Thank you.


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

This means that when it comes to determining the slice, sales and leases are separately and ratably factor represented by their respective gross business
receipts because each separately contributing to
composition of the pie.

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

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

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

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

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

Taxpayer's approach ignores the fact that
Financial Services Business subsequent and separate
lease acquisition from dealers does not undo any of the
previously completed car sales to dealers by MBUSA.

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

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

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

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

Fair factor representation is the standard requirement. Here, given that the standard formula aligns business activities that contribute to calculation of the income pie with the activities that contribute to the calculation of California's slice of the total pie, the application of the standard rules
results in fair factor representation of Taxpayer's overall business activities in this state.

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

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

So where do we go from here?

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

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

This slide merely compares standard with
Taxpayer's proposed formula, with the proposed one
simply providing for a smaller California slice of
Taxpayer's total income pie.

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

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

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

While the party proposing an alternative must
carry the burden of proving by clear and convincing
evidence that the proposed remedy is reasonable, here,
Taxpayer cannot sustain this burden because standard
formula already provides for fair factor representation of distinct business activities.

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

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

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

Taking Taxpayer's argument that lease acquisition cancels out or undoes the original car sales to its natural conclusion requires us to reverse the originally claimed deduction. Otherwise, Taxpayer is treating the same car as if sold for purposes of calculating the pie, and as if unsold for the purposes of calculating the slice. This is not a reasonable method of assigning a portion of total income to California.
As such, Taxpayer's proposed alternative that produces more than 38 million in refunds is not reasonable.

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

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

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

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

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

In conclusion, Taxpayer did not sustain its burden of proving by clear and convincing evidence that the application of the standard rules unfairly reflects
the extent of its California business activity and that Taxpayer proposed alternative is reasonable.

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

This concludes our presentation.

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

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

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

Thank you, guys. I got this.

MEMBER VAZQUEZ: I will wait for the rebuttal.

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

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

These comments, which we do have summarized on a slide, are represented in the brief that they filed. And so I will walk through these, each in turn.

The first argument is that there is no repurchase because effectively you have got separate entities with separate profit motives. This is putting form over substance. We are a single unitary group. We are
required, under California law, to file a single combined report. So when we sell vehicles to dealerships, as required by California Vehicle Code, there's no other way to do it.

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

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

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

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

When we sell wholesale to retailers, to dealers, and we don't buy them back, there is profit. And so, yes, there is a profit margin when we don't buy the vehicles back. And I think that it's pretty clear that
if you are selling for $50,000, the dealer is selling back to us for at least $50,000, we're not making any economic profit. In fact, we are providing the dealer with incentives so that they will serve the customer. If the customer wants to purchase the vehicle, they have equal incentive, as compared to a customer that wants to lease the vehicle.

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

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

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

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

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

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

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

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

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

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

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

If we could, we would lease directly to California customers and we wouldn't be here today. We wouldn't have double counting. We would have the 8 percent apportionment percentage because you wouldn't have that first sale to the dealer that is in the standard apportionment formula. We're here because
California Vehicle Code doesn't allow us to do that
direct leasing to our customers. That's why we sell.
That's why we buy back.

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

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

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

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

FTB Legal Ruling 2019-1 says that the timing and
the value of deductions has no place here in fair apportionment considerations. We're talking about, is it fair to include sales to dealerships that we buy back and then have lease receipts? Is it appropriate to double count that? That's the question. Not depreciation deductions.

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

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

Never, over the course of the two-year audit, did the auditor say he didn't have enough information to
ascertain the basic facts that there was a sale to
dealerships, and when people lease there is a repurchase
of that leased vehicle back.

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

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

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

How in the world can you have an economic profit
on that? Of course we have economic profit on the
wholesale sales that we don't buy back, but when we buy
it back for the same amount or more, how could we
possibly profit from that? That is a double counting of the receipt that we only do because California law won't less -- let us lease directly to our customers. We have to sell to authorized dealerships and buy the product back.

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

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

We have 11 percent of our cars and only 5 percent of trucks and buses. We're winding up with 12 or 13 percent precisely because we're double counting these sales, and it's pulling in those profits on the trucks and buses that we only sell 5 percent in this state.
And so with that, I will -- I will turn it over
to Jon for any further rebuttal and conclusion.

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

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

How much time do they have?

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

CHAIRPERSON COHEN: Great. Thank you.

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

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

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

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

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

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

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

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

Double counting gross receipts associated with leased vehicles artificially inflates Daimler's sales
factor to such an extent that alternative apportionment is not only warranted but mandated.

Excuse me. Let me find myself. Okay.

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

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

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

Instead you heard them look at Daimler's apportionment numbers, and they did not tell you about the Freightliner trucks that are all sold out of the state, 95 percent. Nor do they tell you about the
Thomas Built Buses that are sold outside of the state. Okay? Nor do they tell you about the Thomas Built -- Thomas Built Buses and Western Star Trucks, right?

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

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

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

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

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

Thank you, Madam Chair, and Honorable Board
Members. We conclude our remarks.

CHAIRPERSON COHEN: Thank you very much.

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

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

MEMBER VAZQUEZ: Yes.

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

Member Miller?

MEMBER MILLER: Thank you so much, Madam Chair.

Well, I will defer to --

CHAIRPERSON COHEN: Okay.

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

Thank you.

CHAIRPERSON COHEN: Okay.

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

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

On the repurchase, kind of walk me through this. Because, you know, I'm thinking, when I have leased vehicles, you know, you never really take ownership of these things. You are just basically leasing them. And
then at the end of your lease you are giving it back.

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

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

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

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

MEMBER VAZQUEZ: Right.

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

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

So that margin is a revenue. Had the dealers not sold the lease with the car back to Daimler, then the dealers would earn lease revenue, which would be the lease payment less the cost that it paid when it purchased the car. And the difference would be the interest, plus any markup that dealers put on a car when they lease it.
Because when you lease car, you negotiate the price of the car, right?

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

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

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

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

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

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

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

We are seeing, "Okay. Well, how is the slice calculated?" When the dealer sells the car, they calculate their pie by including revenue from that sale of the car and the reducing that apportionable income pie by the expenses, their cost of goods sold, which is cars that they sold, right?
And then when they -- Daimler's financial arm buys access to stream of payments that already has interest incorporated in those payments, and margins incorporated in those kind of payments, that's another stream of income.

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

And isolating cost from the actual revenue doesn't make any sense, because they are looking at the repurchase at their cost as a non-profitable transaction. Well, cost is not revenue. Cost is something that reduces revenue.

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

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

So your argument is that -- because I know at the
end of the day, when you lease a vehicle, the dealership basically turns over the deed to the -- in this case, I guess it's Daimler -- right? -- that handles this thing. And you, as the lessee, never really take ownership unless you actually buy out the lease at the end of the lease.

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

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

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

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

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

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

MR. SPERRING: Exactly.

MEMBER VAZQUEZ: And then it frees up the dealer from owning -- basically owning that car so then they
can go ahead and buy other vehicles, I imagine.

MR. SPERRING: Exactly.

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

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

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

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

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

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

And so the lease payment is to take into account 
that declining value. You know, the wear and tear on
the vehicle. There is an interest component, but that's not the largest piece.

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

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

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

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

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

But, you know, Jon, you answered most of them.
MEMBER VAZQUEZ: So once the dealership sells that -- basically that vehicle to the lessor, I guess, they never take back ownership of that pink slip, basically. They don't own it at that point.

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

MEMBER VAZQUEZ: Right.

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

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

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

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

Am I correct?

MS. KRASAVTSEVA: This was a claim for refund that Taxpayer failed -- filed. And when Taxpayer files this claim for a refund, it told us that it's entitled to refund because it wants to use alternative
apportionment. It is on the taxpayer to prove that it is entitled to the alternative apportionment. And by "alternative apportionment," I mean deviation from the standard Code rules.

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

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

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

We don't know under which terms the financial arm agreed to buy those from dealers. We have no idea. Because Taxpayer did not provide us with that information. Taxpayer stated to us somewhere during the audit information document request responses that they
paid to dealer for their services of leasing.

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

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

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

So thank you.

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

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

MR. SPERRING: Sure, sure. Yeah.

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

MR. SPERRING: Yes. We provided -- we responded to every IDR that was issued. And as we put on our slide, the auditors had no issue with the documents
Okay. What you are seeing is Legal saying, "Oh, I wish the auditors would have asked for more. And the burden of proof is on the taxpayer; so we're going to come up with things that the auditor could have asked, second-guess the auditor, and then say, 'Taxpayer didn't provide it, you lose, you didn't meet the burden of proof.'"

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

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

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

MEMBER VAZQUEZ: Sure. Go ahead.

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

CHIEF COUNSEL BRUNETT: The auditor is not. The
auditor is in Chicago, but Irina can answer -- she's
been, you know, in contact with the -- with the Audit
staff in terms of what Irina mentioned and what I
represented in terms of what we have done in terms of
the documentation requested.

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

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

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

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

MS. KRASAVTSEVA: We have requested specific to
this issue about eight different IDRs, if not more.
Those IDRs are often -- because it's a claim for refund
and because the taxpayer in a better position to know what they are trying to prove, our questions are open ended. They are telling, "Okay. Please establish, please support this number, please establish your claim, please explain this and that."

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

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

MS. KRASAVTSEVA: Correct.

CHAIRPERSON COHEN: -- "even with specificity?"

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

When we asked access to the work papers that generate the report, so that we can see how that snapshot was created -- right? -- because query is at the control of the person running the query. So we
asked for access. We were not allowed that access. Instead we were given an explanation, how that -- how they came up with that query. So --

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

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

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

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

MS. KRASAVTSEVA: Well, the taxpayer -- the taxpayer's -- the taxpayer's main argument in there is a buyback agreement. We have not seen that. And that would be the key evidence that would show, "Hey, we have this structure where we buy back the cars at this amount. Look."
CHAIRPERSON COHEN: And this information -- how key is it to you for a determination?

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

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

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

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

CHAIRPERSON COHEN: Okay.

Something you wanted to add?
CHIEF COUNSEL BRUNETT: Yes. Thank you. Thank you very much, Chair.

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

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

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

CHIEF COUNSEL BRUNETT: The audit has been. The petition for the alternative apportionment is -- was -- we did fast-track this when Legal and Audit got it to the point where -- to hold the hearing. And then
when -- when Mr. Sperring filed the petition, then we did, you know, get this on the earliest Board we possibly could. So --

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

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


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

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

I will let you take that, Jozel.

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

What -- you know, there's briefing that goes on, and Jon did offer to waive doing a reply brief. But we also have accessibility rules to follow. And we have to
make all of the briefs that are in your binders and the other presentations accessible, which takes some time.

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

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

CHAIRPERSON COHEN: All right. Understood. Thank you.

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

MEMBER VAZQUEZ: Thank you.

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

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

MR. SPERRING: Sure. Sure.

So the first thing that happens -- right? -- is before any car could go to the dealership -- okay? --
and there's -- it varies, but about 50 in California, right? So one year, 48. The next, it went up to 50.

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

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

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

So let me stop there.

Does that answer your question?

MEMBER VAZQUEZ: I think you are getting there.

MR. SPERRING: Okay.

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

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

MS. KRASAVTSEVA: Correct.
MEMBER VAZQUEZ: Walk me through that because I don't --

MS. KRASAVTSEVA: Yes.

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

MS. KRASAVTSEVA: The second sale --

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

MS. KRASAVTSEVA: Sure.

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

MS. KRASAVTSEVA: Well --

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

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

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

So when a dealer leases a car, it sells right to use the car during the lease period. So it is a sale transaction. It is just a cheaper transaction for the
lessee, because the lessee only buys the right for half of the car.

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

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

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

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

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

So it is two transactions. They both have tax consequences. They both have revenue. And they both come with expenses.
If you and I were deciding to participate in income stream, we will have to pay for it, right? That would be our reduction of the revenue from the income stream. So their lease acquisition is simply buying in to receive lease payments as a stream of revenue.

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

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

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

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

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

MS. KRASAVTSEVA: I'm sorry. I don't drive
Mercedes; so I don't know how leases are done. But --

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

MS. KRASAVTSEVA: But I don't own that either.
But -- and I have never leased.

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

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

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

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

MEMBER VAZQUEZ: Okay. Well, let me --

CHAIRPERSON COHEN: All right.

MEMBER VAZQUEZ: Go ahead.

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

So forgive me if they are duplicative in nature, but if anything they are just offering an opportunity
for more clarity.


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

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

CHAIRPERSON COHEN: Okay. Okay.

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

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

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

So my question is, is that how do you address the argument that the vehicles must be sold to a dealership first?
MS. KRASAVTSEVA: Okay. So let's say there was no law; that the dealers --

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

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

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

CHAIRPERSON COHEN: Yes.

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

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

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

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

CHAIRPERSON COHEN: Yes.
MS. KRASAVTSEVA: -- tried -- I tried to explain that there is a relationship between what contributes to the apportionable pie --

CHAIRPERSON COHEN: Yes.

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

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

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

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

So the problem we have with the taxpayer's car is this "disalignment" of what -- the activities that contribute to the revenue and expenses -- they treat these two activities as very separate. Not as one,
right? They treat lease payments and lease acquisitions as separate things that augment the pie, and they treat sales of cars as a separate income-producing activity that also, you know, inflates or reduces the apportionable income pie.

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

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

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

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

This decision would, of course, affect this particular taxpayer that's in front of you.
But in terms of it being binding, per se, it may not be. However, there -- similarly situated taxpayers, that have the same situation as Daimler here, could file claims for refund, could file alternative apportionment if you were to -- the Board were to rule in favor of the taxpayer.

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

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

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

CHAIRPERSON COHEN: Okay. And I believe the apportionment formula -- did -- it changed in 2017? Is that right?
MS. KRASAVTSEVA: The apportionment formula to the single sales factor, do you mean?

CHAIRPERSON COHEN: Yes. Yes.


CHAIRPERSON COHEN: It was in 2013. Okay.


So what led to the change?

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

CHAIRPERSON COHEN: Yes.

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

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

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

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

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

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

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

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

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

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

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

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

They have made up their minds that alternative apportionment is not warranted. Okay? But the bottom
line is, there's really no dispute of the underlying facts here. I mean, there -- you know, there's an argument over semantics --

CHAIRPERSON COHEN: Yeah.

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

CHAIRPERSON COHEN: Okay. Okay.

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

MR. WHITNEY: There's not a --

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

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

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

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

MR. WHITNEY: Yeah.

CHAIRPERSON COHEN: -- I gather that.

MR. WHITNEY: Okay.

CHAIRPERSON COHEN: I -- who introduced this law
in 2013? Who carried that in the legislature? Do you know?

MR. WHITNEY: Kevin de León.

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

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

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

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

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

CHAIRPERSON COHEN: Okay.

MR. WHITNEY: -- together to generate profit.

It's just that on the wholesale sales that we buy back, we don't generate any economic profit because the dealer is not going to sell it for a penny less than what they bought it for.

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

CHAIRPERSON COHEN: Okay. Prior to 2013, was
there this level of confusion?

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

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

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

CHAIRPERSON COHEN: I understand.

MR. WHITNEY: It is what it is.

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

MR. WHITNEY: Yes.

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

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

And that's if MBUSA is not a party to the lease agreement, isn't it true that the assignment of leases is not -- is actually not a repurchase but an acquisition in its own right?
MR. WHITNEY: I mean, I think it's a fair point. It is a separate legal entity that purchases the lease property back. But, again, if it's one unitary business, I go back to my example of left hand, right hand. That I'm selling to a dealer with one hand; but as part of the same unitary body, if you will, the right hand is purchasing it back.

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

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

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

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

MEMBER GONZALEZ: Yes, thank you.

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

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

I also wanted to make sure that I heard this
correctly earlier. It sounds like there may be some additional information that could be analyzed, that may be helpful.

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

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

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

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

MEMBER GONZALEZ: Okay. Great.

Thank you. That's all I had.

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

But do we have a time or a date?

CHIEF COUNSEL BRUNETT: No. It's -- it actually was filed before the petition was filed in this case to your Board. So it was filed. And then the petition was filed. And so it's right now, according to what we
have -- our procedures, what we will usually do is
Office of Tax Appeals will defer it pending -- pending
your Board, as long as the taxpayer has the petition.

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

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

CHIEF COUNSEL BRUNETT: No. Then that --

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

CHIEF COUNSEL BRUNETT: Exactly.

CHAIRPERSON COHEN: -- to make a decision today.

CHIEF COUNSEL BRUNETT: Right.

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

Do we need to take public comment on this
hearing?

(No response.)

CHAIRPERSON COHEN: No. Thank you.

MEMBER VAZQUEZ: Madam Chair, I would like to ask
if there's a willingness here, from at least us here,
present today, to postpone this matter and refer it back
to FTB to further do the audit? Because it sounds like they are open to it, and it sounds like they have some information here that hopefully could come up with a resolution or some kind of compromise.

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

CHAIRPERSON COHEN: Well, that's interesting.

Because I heard probably the exact opposite.

MEMBER VAZQUEZ: Oh, I'm sorry.

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

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

MEMBER VAZQUEZ: I agree.

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

MEMBER VAZQUEZ: I appreciate it, only because, Madam Chair, is that I don't feel comfortable. If you were to move -- for example, let's say you made a motion to decide one way or the other, I would have to abstain,
and I just didn't want to abstain. I would rather make a decision one way or the other, but I don't feel I have all the information.

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

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

CHAIRPERSON COHEN: Okay. So...

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

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

CHAIRPERSON COHEN: That's a good question.

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

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

MEMBER VAZQUEZ: You know, if we could do that.
CHAIRPERSON COHEN: Okay. Okay. I guess --
MEMBER VAZQUEZ: I don't know how much time they
need to gather this and know --
CHAIRPERSON COHEN: Well, let's ask.
How much -- or maybe I don't know. I'm not quite
sure who to direct my question to.
CHIEF COUNSEL BRUNETT: It -- it's okay. It
would depend, of course, upon the taxpayer providing --
when we -- we would send questions, and we can work up
those really quickly on what we need. And then give the
taxpayer time to -- I would say, 30 days -- right? -- to
respond, to be reasonable, to provide that information
to us, and then we would take a look at it. So two
months? Which would be sooner than three.
MEMBER VAZQUEZ: I'm good with that. Whatever --
CHIEF COUNSEL BRUNETT: Well, we need -- we --
it -- it's important for all of us -- right? -- to get
the information to look at it. And so --
MEMBER VAZQUEZ: In a timely manner. I get it.
CHIEF COUNSEL BRUNETT: Right.
MR. HOFELING: And since it will be in open
session, we will have to still comply with Bagley-Keene
about proper noticing.
MEMBER VAZQUEZ: Notices and all that.
CHAIRPERSON COHEN: I don't necessarily think
that we need 60 days.

   What if we were to come --

MEMBER VAZQUEZ: 45.

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

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

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

CHIEF COUNSEL BRUNETT: We can do that.

CHAIRPERSON COHEN: -- and be --

MEMBER VAZQUEZ: Yeah.

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

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

MEMBER VAZQUEZ: Yes.

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

CHAIRPERSON COHEN: Well --

MEMBER VAZQUEZ: I'm sorry?

CHAIRPERSON COHEN: I don't want to interrupt
you. I'm sorry. Go ahead.
MEMBER VAZQUEZ: And you gave it the title. I -- and I guess it has a name for this.

What did you call it?

CHAIRPERSON COHEN: Oh, an IDR.

MEMBER VAZQUEZ: IDR. Yeah.

CHAIRPERSON COHEN: So there is -- there is -- and it sounds like there is just one point, but let --

May I restate the motion?

MEMBER VAZQUEZ: Sure. Go ahead.

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

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

CHAIRPERSON COHEN: Shane. Okay.

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

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

MEMBER VAZQUEZ: That would probably be August.

MR. HOFELING: It would be August 10th.

CHAIRPERSON COHEN: The week in August 10th.

Okay. So...

MEMBER VAZQUEZ: That's a Thursday.

How does that work?

CHAIRPERSON COHEN: Not for me.
MEMBER VAZQUEZ: No? Do you want to do it before or after?

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

MEMBER VAZQUEZ: How about the first week of August?

CHAIRPERSON COHEN: Just give me one minute, please.

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

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

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

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

CHAIRPERSON COHEN: Okay. Third week of August.

Which is one week before our scheduled --
MEMBER VAZQUEZ: No. We're in September.

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

So the third week of August --

MEMBER VAZQUEZ: The week of the 14th.

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

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

Is that the correct motion?

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

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

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

CHAIRPERSON COHEN: All right.

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

Is there a second?

MEMBER VAZQUEZ: Second.

CHAIRPERSON COHEN: Second by Vazquez.

Let's take a vote.
Oh, excuse me. Do we -- do we need to take public comment on this motion?

MR. HOFELING: I'm sorry?

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

MR. HOFELING: No.

CHAIRPERSON COHEN: Okay. Thank you.

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: Aye.

And -- thank you.

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

MEMBER VAZQUEZ: A special meeting.

CHAIRPERSON COHEN: -- in August, third week.

MEMBER VAZQUEZ: Third week of August.

So just move -- move it?

CHAIRPERSON COHEN: I need a second.

MEMBER VAZQUEZ: I will second.

CHAIRPERSON COHEN: All right. Thank you.

The motion has been made and seconded.
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
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