OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18012322
	) CDTFA Account No. 99-427900
IMAGE 2000	) CDTFA Case ID 995623
	)
	)
	)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Mardiros H. Dakessian, Attorney
Lucian Khan, Attorney
Steven Rauser, Attorney

For Respondent: Jarrett Noble, Tax Counsel III

A. KWEE, Administrative Law Judge: On February 4, 2020, the Office of Tax Appeals (OTA) issued a written opinion sustaining a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) on a petition for redetermination filed by Image 2000 (appellant).[1] CDTFA's decision denied appellant's petition of a Notice of Determination (NOD) dated January 20, 2017, for $435,801.46 in tax, plus accrued interest, for the period January 1, 2012, through December 31, 2014 (audit period). CDTFA's decision concluded that appellant failed to establish a basis to grant relief of the taxes and interest pursuant to Revenue and Taxation Code (R&TC) section 6596.

On March 4, 2020, appellant timely petitioned for a rehearing on the basis that there is insufficient evidence to support OTA's written opinion or it is contrary to law. With respect to this ground for a rehearing, appellant contends that OTA's written opinion erred in making two findings, which we will discuss in turn. We conclude that the grounds set forth in this petition do not constitute a basis for a new hearing.

OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (a) an irregularity in the

[1] OTA's written opinion was decided based on the written record.

proceedings that prevented the fair consideration of the appeal; (b) an accident or surprise that occurred, which ordinary caution could not have prevented; (c) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the written opinion; (d) insufficient evidence to justify the written opinion or the opinion is contrary to law; or (e) an error in law that occurred during the proceedings. (Cal. Code Regs., tit. 18, § 30604(a)-(e); *Appeal of Do*, 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654.)

A ground for a rehearing is material if it is likely to produce a different result. (See *Santillan v. Roman Catholic Bishop of Fresno* (2012) 202 Cal.App.4th 708, 728; *Hill v. San Jose Family Housing Partners, LLC* (2011) 198 Cal.App.4th 764; *Trovato v. Beckman Coulter, Inc.* (2011) 192 Cal.App.4th 319.)

Appellant alleges OTA's written opinion is contrary to law or unsupported by any substantial evidence. As provided in the State Board of Equalization (SBE)'s precedential decision in *Appeal of Wilson Development, Inc., supra,* and as reflected in SBE's Rules for Tax Appeals, SBE has historically looked to Code of Civil Procedure section 657 for guidance in determining whether grounds for a rehearing exist. (See, e.g., Cal. Code Regs., tit. 18, §§ 5461(c)(5), 5561(a).) OTA continues to apply the same standards as SBE for granting a rehearing; thus, it is appropriate to continue looking to Code of Civil Procedure section 657, applicable caselaw, and precedential decisions for guidance in determining whether to grant a new hearing.

In order to find that OTA's written opinion is against (or contrary to) law, OTA must determine that the opinion is "unsupported by any substantial evidence." (*Appeal of Swat-Fame, Inc., et al.*, 2020-OTA-045P; *Appeal of Graham and Smith*, 2018-OTA-154P, citing *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906 (*Sanchez-Corea*).) This requires a review of the opinion to indulge "in all legitimate and reasonable inferences" to uphold the opinion. (*Sanchez-Corea, supra*, 38 Cal.3d at p. 907.) The question before us on a petition for rehearing does not involve examining the quality or nature of the reasoning behind OTA's opinion, but whether that opinion is valid according to the law. (*Appeal of NASSCO Holdings, Inc.* (2010-SBE-001) 2010 WL 5626976.) For example, to the extent that the evidence is undisputed or has been accepted in the light most favorable to the prevailing party, the appeal might turn on a purely legal question. In such circumstances, there may be "doubt that [the Panel] had properly

decided the legal issue." (*Arenstein v. California State Bd. of Pharmacy* (1968) 265 Cal.App.2d 179, 187-188.) A rehearing may be granted when, examining the evidence in the light most favorable to the prevailing party, with all legitimate inferences to uphold the opinion, the Panel finds that the written opinion incorrectly stated or applied the law and, as such, it is contrary to law. (*Ibid*.; see also *Russell v. Nelson* (1969) 1 Cal.App.3d 919, 922.)

In summary, we must determine whether, assuming all facts in the light most favorable to the prevailing party, the written opinion can or cannot be valid under the law. (*Appeal of NASSCO Holdings, Inc.*, *supra*.) To the extent only an application of law thereafter remains at issue, the Panel has discretion to conclude that the opinion incorrectly applied the law, on the basis that it cannot be valid under the correct legal interpretation (i.e., it is unsupported by any substantial evidence, assuming all facts in the light most favorable to the prevailing party). (See, e.g., *In Re Wickersham's Estate* (1902) 138 Cal. 355, 360-361.)

R&TC section 6596 authorizes relief of taxes and interest under certain circumstances where a taxpayer reasonably relies on written advice from CDTFA. In our written opinion, we explained that in order for R&TC section 6596 to apply, four requirements must be met. We concluded that the first requirement was met, and that appellant failed to establish the second requirement was met. Based on appellant's failure to meet the second requirement, we did not discuss the remaining two requirements. Our written opinion correctly summarized the second requirement as follows:

> CDTFA must respond in writing, stating whether or not the described activity or transaction is subject to tax, or stating the conditions under which the activity or transaction is subject to tax. (R&TC, § 6596(b)(2).) . . . [¶] With respect to the second element, in order for written advice contained in a prior audit to apply to the person's activity or transaction in question, the facts and conditions relating to the activity or transaction must not have changed from those which occurred during the period of operation in the period audit. (Cal. Code Regs., tit. 18, § 1705(c).)

OTA's written opinion made, in pertinent part, two findings relevant to the second requirement for relief under R&TC section 6596:

> There is no evidence in the available audit work papers that CDTFA ever advised appellant [in writing] that it could report using a taxable ratio of 10 percent in perpetuity, regardless of appellant's actual taxable measure (i.e., cost price of repair parts) .....[¶]

> [W]e find that the facts and conditions relating to the activity have changed since the first audit, and CDTFA advised appellant that it did not examine the specific aspect of the transaction at issue in the second and third audit or verify whether the 10-percent taxable ratio was still correct.

With respect to the first finding, appellant states "the OTA opinion is based on the premise that there was no evidence in the audit workpapers indicating that [appellant] could report tax using [a] 10-percent methodology" and appellant contends this is unsupported by the evidence. Second, appellant further contends that OTA's finding that "the facts and circumstances have changed" is also incorrect.

With respect to the first contention, the issue here is that appellant only quoted half of OTA's finding. Appellant's contention that CDTFA allowed appellant to report only 10 percent of its labor charges as taxable in the first audit period is correct. OTA's written opinion did not conclude otherwise. In the first audit period, the ratio of taxable to nontaxable charges in appellant's invoices was 10 percent, and neither party disputes that this was the correct taxable measure. As indicated above, OTA's written opinion found no evidence that CDTFA advised appellant that it may continue to report based on this 10-percent ratio in perpetuity, or that it may disregard any future increases in *the actual ratio of taxable to nontaxable charges increases*. CDTFA provided evidence to show that the 10-percent ratio in the first audit period "was confirmed by examination of sales invoices for 1Q-00 [(first quarter of 2000)]." It is undisputed that the taxable measure has since increased beyond 10 percent.

Both of the subsequent audits make clear that "No detailed examination of costs was conducted." Instead, the auditor only "requested a sample maintenance contract with list of supplies and parts along with prices to verify percent is still 10%." Appellant cites to no provision in R&TC section 6596, or in the audit work papers, that authorizes appellant to disregard an increase in the actual ratio of appellant's taxable to nontaxable charges, and instead continue to report based on using lower taxable ratios from a prior reporting period. To the contrary, it is clear from the subsequent audits, and in particular from this statement quoted in the audit work papers for both subsequent audits, that the 10-percent reporting ratio was based on the actual ratio of taxable to nontaxable charges in appellant's invoice. During the first audit period, this ratio was 10 percent. During the current audit period, this ratio increased beyond 10 percent. This constitutes a change in the relevant facts and conditions relating to the activity or transaction for purposes of the second requirement to grant relief under R&TC section 6596.

Appellant did not provide evidence to show that CDTFA advised appellant that the law allows appellant to elect to continue to report 10 percent of its total charges as taxable even if the taxable ratio in appellant's invoices increases beyond 10 percent. More importantly, the legal standard for the second requirement of relief under R&TC section 6596 is whether the relevant facts and conditions have changed. We explained above that the pertinent facts and conditions have changed because the measure of taxable charges in appellant's invoices increased.

Based on the foregoing, we find that our written opinion, concluding appellant failed to meet its burden, was supported by substantial evidence. OTA's findings were supported by statements contained in CDTFA's audit files for the prior three audits. Furthermore, appellant had the burden to establish a basis for relief under R&TC section 6596.[2] In summary, we find that appellant failed to establish a ground for rehearing and appellant's petition for rehearing is denied.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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Nguyen Dang
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Nguyen Dang
Administrative Law Judge

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Kenneth Gast
Administrative Law Judge

Date Issued: 8/12/2020

[2] R&TC section 6596 provides that a "person *may be relieved* of the taxes . . . or interest" when the statutory elements are met. (Emphasis added.) We need not address herein the circumstances under which a decision to grant such relief is mandatory, if any, or whether the standard of review of a CDTFA decision to deny R&TC section 6596 relief is that of an "abuse of discretion" standard.