

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In Re: the Matter Appeal of)
)
R. Atkins,) OTA No. 18022352
)
 Appellant.)
)
_____)

TRANSCRIPT OF VIRTUAL PROCEEDINGS

Sacramento, California

Tuesday, October 13, 2020

Reported by:
Dorothy M. Simpson
CSR No. 14323

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TRANSCRIPT OF VIRTUAL PROCEEDINGS, taken at 400 R Street, Hearing Room, Sacramento, California 95811, commencing at 10:00 a.m. and concluding at 12:00 p.m. on Tuesday, October 13, 2020, reported by Dorothy M. Simpson, CSR No. 14323, in and for the State of California.

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APPEARANCES:

Panel Lead: Hon. Andrew Kwee

Panel Members: Hon. Joshua Aldrich
Hon. Keith Long

For the Appellant: Robert P. Merten, III, Attorney
Malcolm A. Brudigan, Attorney

For the Respondent: State of California
Franchise Tax Board
BY: Amanda Jacobs, Tax Counsel
Monica Silva, Tax Counsel
Jason Parker, Hearing

Representative

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1 Sacramento, California; Tuesday, October 13, 2020

2 10:00 a.m.

3

4 JUDGE KWEE: We are on the record. I'll check with
5 the reporter.

6 Are you -- is the reporter ready to go on the
7 record?

8 THE REPORTER: Yes, sir.

9 JUDGE KWEE: Thank you.

10 So we are opening the record on the appeal of
11 Romie Atkins doing business as Naturally Organic Sleep.

12 This matter is being held before the Office
13 of Tax Appeals. The OTA Case number is 18022352. And
14 today's date is Tuesday, October, 13th, 2020, and the
15 time is approximately 10:00 a.m.

16 This hearing was noticed for Sacramento,
17 California, and is being conducted electronically with
18 the agreement of the parties.

19 Today's hearing is going to be heard by a
20 panel of three administrative law judges. My name is
21 Andrew Kwee, and I will be the lead administrative law
22 judge. Judge Joshua Aldrich and Judge Keith Long will
23 be the other members of this panel, although all three
24 judge -- all three judges will meet after the hearing
25 and produce a written decision as equal participants.

1 Although the lead judge, myself, will be
2 conducting the hearing, any judge on this panel may ask
3 questions and otherwise participate to ensure we have
4 all the information needed to decide this appeal.

5 For the record, will the parties, please,
6 state their names and who they represent, starting with
7 the representatives for the taxpayer.

8 MR. BRUDIGAN: Good morning, your Honor --

9 MS. ROBERTS: Good morning. Carley Roberts -- go
10 ahead, Malcolm.

11 MR. BRUDIGAN: Good morning, your Honor. Malcolm
12 Brudigan for the appellant, Romie Atkins.

13 MS. ROBERTS: Carley Roberts with Pillsbury for
14 Petitioner.

15 MR. MERTEN: Robert Merten, as well, Pillsbury for
16 Appellant.

17 JUDGE KWEE: Okay. Great. And let's go to the
18 CDTFA. Who do we have as the representatives for CDTFA?
19 Please identify themselves.

20 MS. JACOBS: This is Amanda Jacobs with the CDTFA.

21 JUDGE KWEE: Okay. I'm sorry. Amanda, I'm just
22 going to pause for one second.

23 I have been informed there is a problem with
24 the live stream, could the parties -- could we go off
25 the record momentarily? I believe they are not live

1 streaming. I'm going to pause the hearing and go off
2 the record for one moment.

3 Thank you.

4 (Off the record from 10:10 a.m. until 10:32
5 a.m.)

6 JUDGE KWEE: We are reopening the record in the
7 appeal of Romie Atkins doing business as Naturally
8 Organic Sleep.

9 When we last left off, the taxpayers'
10 representatives had just identified themselves for the
11 record, and, I believe, Amanda Jacobs for CDTFA had
12 identified herself for the record.

13 And I believe we have two additional
14 representatives to please identify themselves.

15 MS. SILVA: Yes. Monica Silva for CDTFA.

16 MR. PARKER: And Jason Parker for CDTFA.

17 JUDGE KWEE: Okay. Great. Thank you.

18 So with that said, I would just like to
19 briefly go over the logistics.

20 As far as witnesses, we have no witnesses to
21 testify today, and the presentations will consist of
22 oral argument only.

23 As far as the exhibits for CDTFA, I have
24 Exhibits A through C. These exhibits are the same
25 documents that were attached to our Minutes and Orders

1 after our second Prehearing Conference, and they were
2 also emailed to the parties. Appellant did not raise
3 any objections to CDTFA's exhibits.

4 And for the taxpayer -- Appellant, for
5 Appellant we have Exhibits 1 through 10. Those were
6 also attached to the Minutes and Orders of our second
7 Prehearing Conference and emailed to the parties, and
8 CDTFA did not raise any objection to Appellant's
9 exhibits.

10 So I'll start with CDTFA.

11 CDTFA, is the summary that I just provided
12 correct?

13 MS. JACOBS: That's correct.

14 JUDGE KWEE: Okay. And for Appellant, is the
15 summary that I just provided correct?

16 MR. BRUDIGAN: Yes, your Honor. That's correct.

17 JUDGE KWEE: Great. The exhibits that were
18 attached to the Minutes and Orders and just summarized
19 are now admitted in the evidentiary record.

20 With that said, I believe, Appellant
21 submitted a request yesterday evening to display
22 exhibits on the web stream, and I'm just following up to
23 confirm that these are documents that were just
24 submitted into evidence and there's going to be no new
25 information that has to be shared.

1 MR. BRUDIGAN: That's correct. This is Malcolm
2 Brudigan.

3 We'll be sharing excerpts of regulations and
4 statutes that were mentioned in the briefs, so it
5 probably won't be any exhibits, but -- so it will
6 primarily be regulations and statutes.

7 JUDGE KWEE: Okay. And I believe everyone from
8 CDTFA is participating by video, so they will be able to
9 see the screen share, but I would double check.

10 Does CDTFA have any concerns, objections with
11 screen share regulations?

12 MS. JACOBS: We do not.

13 JUDGE KWEE: Okay. Great. With that said, I'll go
14 over the issues. We have three issues, I believe, for
15 today.

16 The first was whether the determination is
17 timely.

18 The second was whether Appellant's sales were
19 exempt from tax.

20 And the third was whether the doctrine of
21 equitable estoppel applies as to any portion of the
22 liability.

23 With the parties -- do the parties have any
24 issues with the issue statement? Or is that a correct
25 statement of the issues?

1 I'll start with the CDTFA.

2 MS. JACOBS: That is correct.

3 JUDGE KWEE: Okay. For Appellant?

4 MR. BRUDIGAN: That's correct, your Honor.

5 JUDGE KWEE: Great. As far as how the timing
6 breaks down, we allocated 30 minutes per party for an
7 opening presentation, and 10 minutes per party for
8 closing presentation, and the judges will be able to ask
9 questions of either party during the -- following their
10 presentation.

11 Does anyone have questions about this process
12 before we proceed with the hearing?

13 MR. BRUDIGAN: No, your Honor.

14 JUDGE KWEE: Okay. Great. So with that said, we
15 are ready to start with Appellant's opening
16 presentation.

17 Appellant, you have 30 minutes. You may
18 proceed.

19 MR. BRUDIGAN: Thank you, your Honor.

20

21 PRESENTATION

22 MR. BRUDIGAN: Good morning. I am Malcolm
23 Brudigan, and along with my co-counsel, Carley Roberts
24 and Robert Merten, we represent Romie Atkins, the
25 appellant in case.

1 For 20 years, Romie Atkins and her husband,
2 Howard Atkins, operated Naturally Organic Sleep, which
3 was a small, family-owned business in Burlingame. Their
4 business sold organic, prescription mattresses. Their
5 customers were patients who had obtained a prescription
6 from a licensed medical professional for special
7 mattresses free from toxic chemical substances. These
8 individuals had a particular adverse reaction or
9 allergic response to conventional mattresses and the
10 harmful chemicals used in them, such as flame
11 retardants.

12 Now, a few years ago in 2018,
13 Mr. and Mrs. Atkins decided to close their business.
14 They were both in their 80s, they were suffering from
15 various health maladies that made continuing the work
16 very difficult. Mr. Atkins, for example, suffered a
17 heart attack, multiple strokes, and he even had an
18 on-the-job injury in that final year in 2018. And now
19 they are in retirement, and they are trying to enjoy it.

20 But the Department has issued an erroneous
21 sales tax assessment that has been a significant
22 stressor in their golden years. Now that they are both
23 on a fixed income, the Department's assessment would
24 cause them significant financial hardship.

25 The legal issue before the OTA is whether

1 Mr. and Mrs. Atkins are liable for sales tax for
2 prescription mattresses their business sold during the
3 taxable period January 1, 2013, to March 31st, 2014, a
4 15-month period.

5 Today we will walk through the three reasons
6 why these prescription mattresses sold by
7 Mr. and Mrs. Atkins are not subject to tax.

8 The first reason is straightforward and
9 procedural. It's also a threshold issue. The
10 Department did not follow its own audit procedures when
11 obtaining a waiver of the Statute of Limitations period
12 from the taxpayer. In short, the waivers obtained by
13 Department were invalid, and so the resulting Notice of
14 Determination was untimely.

15 The second reason is substantive and it
16 concerns a statutory exemption from sales tax. The
17 special prescription mattresses sold by Mr. and Mrs.
18 Atkins were exempt from California sales and use tax
19 under the prescription medicine exemption, which is
20 found in California Revenue Taxation Section 6369.

21 And a third and independent reason Mr. and
22 Mrs. Atkins are not subject to tax is because the
23 government is estopped. In their diligent efforts to
24 comply with the law and collect taxes that were due, Mr.
25 and Mrs. Atkins relied on the Department's direct advice

1 that the prescription medicine applied to their
2 prescription mattresses sales. They took multiple steps
3 to contact the Department and make sure that they were
4 treating these sales correctly for sales tax purposes.
5 But for the Department's advice, we would not be here
6 today.

7 The first reason is the threshold issue, so
8 I'll turn to that one first.

9 The Department's Notice of Determination is
10 invalid because it was issued after the Statute of
11 Limitation period expired. Now, the Taxpayers' Bill of
12 Rights broadly protects taxpayers when the State and
13 assessing and collecting taxes.

14 And one specific provision that ensures
15 fairness during taxpayer audits is found in the
16 Department's own regulations, and that's Title 18 on
17 Section 1698.5 and it concerns the Department's
18 procedures for conducting an audit. And in subdivision
19 (b) of that regulation, it provides that in order for a
20 waiver to be valid, there are to procedural
21 requirements.

22 And so at this time I'm going to share my
23 screen so that we can look at the text of this
24 regulation together. Bear with me for a moment. So
25 unless I hear otherwise, I assume everyone can see the

1 screen here.

2 So the two requirements -- or the first
3 requirement in order to receive avenue valid waiver is
4 the first block of text here, and it provides, "Auditor
5 shall request taxpayer sign a waiver of limitation when
6 there is sufficient information to indicate that an
7 understatement or overstatement exists, but there is
8 insufficient time to complete the audit before
9 expiration of the Statute of Limitations."

10 The second requirement is, quote,
11 "Supervisory approval of the circumstances which
12 necessitated the request for the waiver will be
13 documented in the audit before the waiver is presented
14 to the taxpayer for signature."

15 Here the auditor failed to comply with both
16 of these requirements. First, the Department sent a
17 waiver without any information as to whether an
18 understatement of taxes existed, contrary to the first
19 requirement outlined here.

20 Now, preliminarily, we requested and reviewed
21 the entire audit file. We raised this in Mrs. Atkins'
22 opening brief, and the Department has not provided any
23 evidence in response showing that there was some sort of
24 showing or evidence that an understatement in taxes
25 could have existed when the waiver was sought. And, in

1 fact, that the first waiver request, it was sent less
2 than two weeks after the initial correspondence from the
3 Department initiating the audit. At that time, the
4 auditor had not obtained any books or records when the
5 waiver was sought, and ultimately the auditor only
6 communicated with Mr. Atkins at that time to threaten
7 him with penalties unless he executed a waiver. There
8 was simply no time nor evidence in the audit file to
9 indicate that an understatement of taxes could have
10 existed when that waiver was sought.

11 Now, second, the Department obtained two
12 waivers from Mr. Atkins -- or one from Mrs. Atkins and
13 one from Mr. Atkins after he signed a POA, yet it failed
14 to obtain and document supervisorial approval for either
15 of them, which is contrary to the second requirement,
16 which clearly states that supervisorial approval will be
17 documented. There is no indication or supporting
18 documentation anywhere in the record or the entire audit
19 file, and so this fact alone is fatal for the relevant
20 time periods.

21 So because the Department failed to follow
22 their own audit procedures that are codified in this
23 regulation 1698.5, specifically subdivision (b), the two
24 waivers of the Statute of Limitations obtained by the
25 Department were invalid.

1 I just went ahead -- I'm going to stop
2 sharing my screen now.

3 On -- in addition, to failing to secure a
4 proper waiver, the Department also wrongly imposed sales
5 and use tax on Mr. and Mrs. Atkins because their
6 prescription mattresses fall within the statutory
7 exemption.

8 Now, California Revenue and Taxation Code
9 Section 6051 imposes a sales tax on a retailer's sales
10 of tangible personal property unless the sale is
11 specifically exempt or excluded by statute.

12 One such exemption is the prescription
13 medicine exemption under Section 6369. Until this
14 appeal, there was only one part of this exemption that
15 was contested, and that's the primary issue of whether
16 the prescription mattresses satisfied the definition of
17 medicines. However, in its briefing for these
18 proceedings, the Department has added a second
19 last-ditch argument that we will also address, and
20 that's whether the prescription mattresses were sold or
21 furnished in an exempt manner.

22 One thing that is not at issue is whether the
23 mattresses were sold pursuant to a prescription from a
24 licensed medical professional. During the course of the
25 audit, the taxpayer was asked to produce copies of

1 prescriptions from patients. These valid prescriptions
2 were provided, and the Department never challenged their
3 validity, and this is well documented in the Decision
4 and Recommendation.

5 So turning to the primary issue of the
6 exemption, which is about how prescription mattresses
7 meet the definition of medicines. Now, medicines
8 includes any substance intended for use by external
9 application to the human body in the curing, mitigating,
10 treating, or preventing a disease, and which is commonly
11 recognized as intended for that use.

12 And here there is no doubt these prescription
13 mattresses were externally applied to one's body any
14 time a patient laid down on one. But, really, the
15 critical piece is that the prescription mattresses were
16 prescribed by a licensed medical professional for a
17 specific purchase -- purpose, mitigating, and preventing
18 disease that was caused by conventional mattresses that
19 had various chemicals in them, such as flame retardants.
20 The patients who obtained prescriptions and bought these
21 special mattresses, they were unusually susceptible or
22 had a severe, allergic response to the dangerous
23 chemicals found in conventional mattresses.

24 So the prescription mattresses bought by Mr.
25 and Mrs. Atkins, they were, in effect, a treatment.

1 And, in fact, it was later determined that one of these
2 toxic chemicals I have mentioned -- flame retardants --
3 it can be extremely dangerous. In fact, the National
4 Institute of Environmental Health Sciences found that
5 contact with flame retardants is associated with a slew
6 of adverse health effects. It can impact our immune
7 system, it can have an impact on reproductive toxicity,
8 it can cause cancer, it can have adverse effects on
9 fetal and childhood development and neurologic function,
10 among other issues.

11 So, likewise, the U.S. Consumer Product
12 Safety Commission, they reached a similar conclusion
13 about flame retardants and so the State actually banned
14 their use in mattresses in 2017.

15 But the take away here, that the Atkins were
16 performing an important public service by making these
17 prescription mattresses available to patients who had a
18 legitimate medical need and a resulting prescription
19 from a licensed medical professional.

20 Now, in its Decision and Recommendation on
21 Administrative Appeal, the Department got this wrong.
22 It concluded that the prescription mattresses sold by
23 Mr. and Mrs. Atkins were not medicines under the
24 statute -- under the exemption. The Department
25 mistakenly relied on subdivision (c)(2) of the

1 regulation, which is Regulation 1591, and it found that
2 prescription mattresses, they were similar in nature to
3 other items, such as physical equipment, appliances, and
4 hospital beds, which were excluded from the exemption.

5 But the prescription mattresses here are not
6 like that. They were sold pursuant to prescription from
7 a licensed medical professional, whereas the other items
8 I just mentioned -- physical equipment, appliances, and
9 hospital beds -- they are not. And also, it's important
10 to understand the distinction between the prescription
11 mattresses that were being sold and the hospital beds
12 mentioned in -- in the provision that excludes them
13 exemption. Hospital beds are used when someone is being
14 treated in a hospital. They don't provide any inherent
15 benefits towards treating the patients themselves. By
16 contrast, the prescription mattresses here, they were
17 purposely created and prescribed certain patients to
18 treat that patient's ailments resulting from exposure to
19 conventional mattresses.

20 So in this manner, the prescription
21 mattresses fulfill the prescribed medicine exemption,
22 because they were sold for this specific purpose of
23 mitigating, preventing, and treating disease caused by
24 the toxic chemicals contained in conventional
25 mattresses. And, at bottom, there is no doubt that the

1 mattresses were externally applied to a human's body to
2 achieve these desired mitigation and prevention results.
3 So the prescription mattresses satisfied the definition
4 of medicine under the statute.

5 So the second issue within the prescription
6 medicine exception is a secondary point, and this was
7 not raised in the Department's Decision and
8 Recommendation, and as a result the Department's has the
9 burden to establish this -- this point. And that's
10 clarified in the OTA's Decision in the matter of the
11 Appeal of Praxair, which provides that the burden is on
12 the Department when it introduces a new theory on
13 appeal, and the new theory requires either presenting
14 different evidence, or could result in a greater
15 deficiency, and because the Department is raising this
16 new argument for the first time here, it require -- and
17 would require new evidence to support it, the Department
18 has the burden to establish this point.

19 Now, what's at issue is whether the
20 mattresses were sold or furnished under the conditions
21 outlined in Regulation 1591 subdivision (d) and then
22 there's subparagraphs 1 through 6. And in order for the
23 exemption to apply, one of those six conditions must be
24 satisfied, and the Department's position is that none of
25 these conditions were met. And so I'm going to go ahead

1 and share my screen one more time so that I can show you
2 that they were, in fact, met.

3 So the applicable condition that was
4 satisfied by Mr. and Mrs. Atkins is shown in subdivision
5 (d)(2) which states "Tax does not apply to the sale or
6 use of medicines when sold or furnished under one of the
7 following conditions." And then under condition 2,
8 "furnished by a licensed physician, dentist, or
9 podiatrist to his or her own patient for the treatment
10 of the patient." And then in turn the word "furnish" is
11 defined under the same regulation under subdivision
12 (a)(3). It means to supply by any means by sale or
13 otherwise.

14 So through Mr. and Mrs. Atkins, the licensed
15 medical professionals furnished the prescribed
16 medicine -- in this case, the prescribed -- prescription
17 mattresses for their patients. So the statutory and
18 regulatory language is met here.

19 And really more to the point, the
20 Department's own guidance supports this interpretation.
21 For example, in a 1992 tax annotation, the Department
22 found that in medically prescribed foot device qualified
23 for the exemption, even though the vendor of the device
24 was not a licensed physician and neither was the
25 patient. So the Department specifically found this foot

1 device was a medicine that had been, quote, "furnished
2 by a licensed physician to his own patient for the
3 treatment of the patient."

4 We have the identical situation here. A
5 medically prescribed mattress used to prevent or
6 mitigate disease from toxic chemicals contained in
7 conventional mattresses.

8 And in addition, there's even a second tax
9 annotation from the year prior in 1991 where the
10 Department also found that a non-licensed vendor could
11 qualify under the prescription medicine exemption
12 because its medicines would be considered to be
13 furnished by a physician for treatment of a patient.

14 So, thus, Mr. and Mrs. Atkins have satisfied
15 this condition of the exemption, and as a result, the
16 prescription mattresses both constitute medicines under
17 the statute, and they were furnished by a licensed
18 physician for treatment for patients. So this -- so the
19 prescription medicine exemption applies.

20 Now, for all the foregoing reasons, we
21 believe the sales and questions were exempt from sales
22 tax. If the OTA determines that they are not, then we
23 contend the Department must be estopped from making the
24 assessment, and here's why. The Doctrine of Equitable
25 Estoppel prevents the Department from asserting tax

1 liability against tax taxpayers if the Department has
2 taken action that the taxpayer relied on to their
3 detriment. Estoppel is applied to prevent a great
4 injustice, and that's the case here.

5 Mr. and Mrs. Atkins had ample reason not to
6 collect tax on their prescription mattresses. They
7 performed due diligence that was above and beyond what
8 would be expected of a reasonable sole proprietor of a
9 small family-owned business, and based on that due
10 diligence, they reasonably understood that the
11 prescription medicine exemption applied.

12 And indeed it is the State that told them it
13 did. Here are the facts. First, Mr. and Mrs. Atkins
14 received a notice from their mattress supplier for these
15 special mattresses informing them in writing that
16 California was a state where the prescription mattress
17 sales were exempt. Now, even after receiving this
18 notice, they didn't take it at face value. Mr. Atkins,
19 himself, sought advice from the Department, and, as he
20 attested to in his declaration, the Department advised
21 him that the sale of prescription mattresses were exempt
22 from sales tax, and, in fact, the Department explained
23 to him how to report and claim the exemption on the tax
24 return.

25 And, finally, Mr. and Mrs. Atkins strictly

1 followed this advice from the Department, and, but for
2 the Department's instructions, the Atkinses would have
3 collected and remitted tax on those sales. And they did
4 this -- you know, they didn't collect tax knowing the
5 consequences that could ensue from collecting taxes from
6 customers that were not owed. And this shows that they
7 were taking their tax collecting and reporting
8 obligations seriously -- seriously.

9 And notably, Mr. and Mrs. Atkins followed
10 this advice from the Department for over 30 quarters
11 without any issue.

12 And so Equitable Estoppel must be applied to
13 prevent the Department from assessing sales tax when the
14 assessment is directly the result of the Department's
15 incorrect advice to the taxpayer.

16 Now, to recap, there are three independent
17 reasons why the Department's assessment is invalid.

18 First, the Department did not execute a
19 proper Statute of Limitations waiver. The auditor did
20 not follow the two requirements codified in Regulation
21 1698.5. There was no documentation that a supervisor
22 granted approval, nor was there any evidence that the
23 Department had adequate information that an
24 understatement in taxes existed when the waiver was
25 sought.

1 Second, the prescription mattresses satisfied
2 the prescription medicine exemption. The mattresses
3 were prescribed to patients by licensed medical
4 professionals, and those prescriptions were filled at
5 Mr. and Mrs. Atkins' business. The prescription
6 mattresses were intended to treat and mitigate diseases
7 caused by the chemicals in conventional mattresses, and
8 they were commonly recognized as doing so. And in
9 addition, the prescription mattresses were furnished in
10 an exempt manner because they are purchased pursuant to
11 a valid prescription from a licensed health
12 professional.

13 Third, Mr. and Mrs. Atkins detrimentally
14 relied on the Department's affirmative advice. They
15 conducted reasonable due diligence, and they were
16 actively trying to comply with the law. They should not
17 be punished due to the Department's erroneous advice.

18 For these reasons, Mr. and Mrs. Atkins
19 respectfully request reversal of the D&R in its
20 entirety.

21 Thank you.

22 JUDGE KWEE: Okay. Thank you. This is Judge Kwee.

23 Before we have -- I turn it over to the panel
24 for question, I'm going to allow the CDTFA to have their
25 opening presentation.

1 So, CDTFA, you may proceed when you are
2 ready.

3

4 PRESENTATION

5 MS. JACOBS: This is Amanda Jacobs for the
6 California Department of Tax and Fee Administration.

7 Can you all hear me?

8 JUDGE KWEE: Yes, we can hear you. Thank you.

9 MS. JACOBS: Thank you.

10 As you are aware, under the Revenue Tax Code
11 Sections 6012 and 6051, sales tax applies to a
12 retailer's gross receipts from the retail sale of
13 tangible personal property in the state, unless the sale
14 is a specifically exempt or excluded from taxation by
15 statute. A retailer's gross receipts are presumed to be
16 taxable until proven otherwise, and the burden is on the
17 retailer to establish that its retail sales are not
18 subject to tax.

19 Statutes granting a tax exemption are
20 strictly construed to avoid enlarging or extending the
21 concession beyond the plain meaning of the language used
22 in granting it. See Associated Beverage Company versus
23 Board of Equalization 1990, case 224 Cal. App. 3d 192.

24 Appellant bears the burden of showing it
25 clearly comes within the terms of the exemption by a

1 preponderance of the evidence. See Regulation 35003
2 subdivision (a) in Payne versus State Board of
3 Equalization 1982 case, 137 Cal. App. 3(k) 438 443.

4 There is no dispute that during the liability
5 period Appellant was a retailer during business in
6 California or the Appellant made retail sales of
7 prescription mattresses. Appellant claims nontaxable
8 sales of prescription mattresses on the sales and use
9 tax returns. The issue is whether prescription
10 mattresses qualify as medicines for purposes of the
11 exemptions.

12 Revenue and Taxation Code Section 6369, which
13 is interpreted and implemented by Regulation 1591,
14 exempts from sales and use tax the gross receipts for
15 the sale of or storage, use, or consumption of medicines
16 as defined if they are dispensed or otherwise provided
17 to the patient under certain specified circumstances.
18 Thus, in order to qualify for exemption, a transaction
19 must be both, one, involve a medicine as defined by
20 statute, and, two, be dispensed or otherwise provided to
21 a patient under certain circumstances as specified by
22 statute. The transactions at issue fail on both counts.

23 For purposes of the exemption, medicine is
24 defined by Regulation 1591(a)(1) and Revenue and
25 Taxation Code Section 6963(b) as, quote, "Any substance

1 or preparation intended for use by external or internal
2 application to the human body in the diagnosis, cure,
3 mitigation, treatment, or prevention of disease, and
4 commonly recognized as a substance or preparation
5 intended for that use." Or, quote, "Any product fully
6 implanted or injected in the human body, or any drug or
7 any biologic when such are approved by the United States
8 Food and Drug Administration to diagnose, cure,
9 mitigate, treat, or prevent any disease, illness, or
10 medical condition regardless of ultimate use." End
11 quote.

12 As relevant to this appeal, Section 6369(b)
13 excludes from the definition of medicines, quote,
14 "articles that are in the nature of splints, bandages,
15 pads, compresses, supports, dressings, instruments,
16 apparatus, contrivances, appliances, devices, or other
17 mechanical or electronic optical, or physical equipment
18 or article or the component parts and accessories
19 thereof." End quote.

20 The mattresses at issue are clearly not a
21 substance or preparation that can be applied to the
22 human body internally or externally, nor are they
23 implanted or injected in the body, nor are they a drug
24 or biologic. Thus prescription medicines -- thus
25 prescription mattresses do not meet the statutory and

1 regulatory definition of a medicine.

2 Furthermore, in Appellant's Exhibit 2, the
3 mattress supplier states that mattresses are durable
4 medical equipment. Thus, as equipment, a mattress is
5 previously excluded from the definition of medicine
6 under Section 6369(b). Even equipment prescribed or
7 ordered by a physician may be excluded from the
8 definition of medicine. See sales and use tax
9 annotation 425.0172.

10 Appellant argues that mattresses are a
11 preparation intended to intend to mitigate and prevent
12 adverse health effects caused by flame retardant
13 chemicals. Regulation 1591(a)(9)(b) defines medicine as
14 a preparation intended for use by external or internal
15 application to the body. It is unclear how a mattress
16 may be applied to the body, even externally. Nor is it
17 reasonable to find a mattress commonly recognized as a
18 substance or preparation. Regulation 1591(b)(1) goes on
19 to describe preparations and similar substances to
20 include drugs, such as penicillin and other antibiotics,
21 70 percent solution alcohol and isopropyl, aspirin, baby
22 lotion, oil, and powder, enemas, hydrogen peroxide,
23 lubricating jelly, medicated skin creams, oral
24 contraceptives, vaccines, topical creams and ointments,
25 and sterile and non-pyrogenic distilled water.

1 It is clear from this list that a mattress is
2 not remotely similar to commonly recognized substances
3 or preparations, but it is as categorized by the
4 manufacturer in Appellant's exhibits in the vein of an
5 article or equipment, which were specifically excluded
6 from the definition of medicine.

7 Finally, in order to qualify for exemption, a
8 medicine, which, again, these mattresses are not, must
9 be sold or furnished under one of the six conditions
10 specified in Section 6369(a). It is undisputed that
11 Appellant is the retailer who sold these mattresses.
12 There is no assertion or any evidence that Appellant was
13 a pharmacist or licensed physician, dentist, or
14 podiatrist or a health facility, or a pharmaceutical
15 manufacturer or distributor.

16 Nor has there been any assertion or any
17 evidence that Appellant's mattresses were sold to the
18 State, a political subdivision, or municipal
19 corporation, or to a licensed physician, dentist,
20 podiatrist, or health facility. Therefore, even if
21 these mattresses were medicines, which they clearly are
22 not, Appellant's sales do not come within statutory
23 requirement for tax exemption.

24 Appellant has claimed that because there was
25 a prescription, the items were furnished by a medical

1 professional. This is a misreading of Regulation
2 1591(a)(2). Even medical equipment prescribed or
3 ordered by a physician may be excluded from the
4 definition of medicine. See annotation 425.0172.

5 Appellant cited sales and use tax annotation
6 425.0295 to attempt to disregard the requirements in
7 Section 6369(a) and Regulation 1591(d). That annotation
8 addresses an orthotic device and applies Regulation
9 1591(b)(4), which specifically eliminates the
10 requirement that a medicine be furnished --

11 THE REPORTER: Ma'am? Ma'am? Stop. Stop.

12 JUDGE KWEE: The reporter is having problems.

13 MS. JACOBS: I'm sorry.

14 JUDGE KWEE: Okay. This is Judge Kwee. You may
15 resume. Thank you.

16 MS. JACOBS: This is Amanda Jacobs.

17 So annotation 425.0295 addresses an orthotic
18 device and applies Regulation 1591(b)(4), which
19 specifically eliminates the requirement that a medicine
20 be furnished by a pharmacist and deems prescription
21 orthotic devices to meet the statutory requirement
22 regardless of who furnishes them.

23 A similar exception is provided for
24 prescription prosthetic devices in Regulation
25 1591(b)(5). However, mattresses are not -- are not

1 orthotic or prosthetic devices and cannot benefit from
2 these exclusive, specific exceptions.

3 Appellant also cited or referred to
4 annotation 425.0030, which allows the medical exemption
5 even when the purchaser did not qualify as a health
6 facility if the purchaser meets one of the other
7 requirements in Regulation 1591(d). This is consistent
8 with the law and the Department's position, and that is
9 they may only be sold or furnished under one of the six
10 circumstances outlined by statute. The issue here is
11 that none of the circumstances are met.

12 The next issue in this appeal is whether the
13 Department issued a timely Notice of Determination. The
14 evidence shows that a timely NOD was issued. Revenue
15 and Taxation Code Section 6488 provides, quote, "If
16 before the expiration of the time prescribed in Section
17 6487 for the mailing of the Notice of Deficiency
18 Determination, the taxpayer has consented in writing to
19 the mailing of the notice, after such time the notice
20 may be mailed at any time prior to the expiration of the
21 period agreed upon. The period so agreed upon may be
22 extended by subsequent agreements in writing made before
23 the expiration of the period previously agreed upon."
24 End quote.

25 In other words, a valid waiver requires

1 consent by the taxpayer in writing obtained before the
2 statutory deadline, neither of which is disputed here.
3 The deadline for issuing NOD for the first quarter in
4 the audit period, first quarter 2013, was April 30th,
5 2016. Appellant signed the first waiver on March 24th,
6 2016, before the Statute of Limitations expired to
7 extend the Statute of Limitations to July 31st, 2016.
8 Appellant signed another waiver on May 5th, 2016, to
9 again extend the deadline to January 31st, 2017. The
10 Department issued the NOD on August 3rd, 2016, well
11 before the expiration of the extension. Furthermore,
12 the deadline for issuing the NOD for third quarter 2013
13 was October 31st, 2016, thus, even without the validly
14 executed waivers, which we have in this case, the NOD
15 was timely issued for third quarter 2013 through the
16 remainder of the liability period. Documentation may be
17 found in Appellant's exhibits 4 and 5 and the
18 Department's Exhibits B for the NOD and C, subfolder
19 forms subfolder BOE-122.

20 Regulation 1698.5(b)(3) states that, quote,
21 "Auditor shall request taxpayers sign a waiver of
22 limitation when there is sufficient information to
23 indicate an understatement or overstatement exists but
24 there is sufficient time to complete the audit before
25 the expiration of this Statute of Limitations," end

1 quote.

2 It goes on to state that supervisory approval
3 of the circumstances which necessitated the request for
4 the waiver will be documented in the audit before the
5 waiver is presented to the taxpayer for signature.

6 We note that the regulation does not provide
7 nor is there any legal authority elsewhere that a
8 validly executed waiver conforming to the statutory
9 requirements is invalid.

10 Regardless, the evidence as documented in the
11 414Z found in Appellant's Exhibit 3 and Department's
12 Exhibit C subfolder forms, subfolder BOE 414Z
13 establishes not only the basis for both waivers, but
14 also the supervisor and district principal auditor's
15 awareness and approval before Appellant was sent and
16 presented the waivers to sign.

17 First, the auditor had sufficient information
18 to suspect that a understatement existed. Appellant's
19 business was coded as a furniture store upon
20 registration. Well, it self-reported quarterly gross
21 sales ranged between \$68,000 and \$144,000. Appellant
22 claimed over 90 percent as nontaxable, which is
23 uncommon. An exempt sales is a common area for
24 reporting errors. See the 414M in Exhibit C for
25 evidence of Appellant's reporting.

1 For the March 2016 waiver, the 414Z shows
2 that upon receiving the audit assignment, the auditor
3 attempted to contact Appellant via letter and two voice
4 mails with no response. Finally, on March 18th, the
5 district principal auditor issued a BOE 79G letter
6 addressed to Appellant informing her that an estimated
7 billing was necessary due to an inability to make
8 contact and asking Appellant to contact the DPA at her
9 direct phone number provided in the letter. See 414Z as
10 well as the 79G letter in Exhibit C, subfolder
11 correspondence subfolder letters.

12 Thus the DPA, who is senior to an audit
13 supervisor, had knowledge of the futile attempts to make
14 contact with Appellant regarding the audit and her
15 knowledge was clearly documented in the audit. After a
16 79G letter is sent, a supervisor or DPA would approve
17 any request or waiver. Four days after the 79G letter
18 was sent, the auditor mailed Appellant the waiver form
19 as evidenced in the 414Z.

20 The May 2016 waiver was signed while
21 Appellant was at the district office during a ten-day
22 discussion facilitated by the district principal
23 auditor, Karen Chavez. An April 15th entry by Sheri
24 Checchi, the supervising tax auditor, records a
25 conversation with Mr. Atkins regarding the upcoming

1 ten-day discussion, and a later May 5th entry documented
2 that the taxpayer signed the waiver extension at the
3 ten-day to allow Appellant to get necessary records to
4 the auditor. See 414Z and BOE -- and Form BOE 836A in
5 Department's Exhibit C, subfolder, forms subfolder BOE
6 836 under BOE represented by, it shows that the DPA was
7 present at the ten-day discussion. And again, the DPA
8 is superior to an audit supervisor, and thus has
9 ultimate supervisory approval.

10 The evidence shows that there was sufficient
11 information to necessitate the waiver of limitations,
12 supervisory approval for both waivers, and both waivers
13 executed by Appellant met the statutory requirements.

14 Therefore, the Department issued timely
15 Notice of Determination.

16 The final issue in this appeal is whether the
17 doctrine of equitable estoppel applies to any portion of
18 the Appellant's liability. It does not. As a general
19 matter, equitable powers can only be exercised by a
20 court of general jurisdiction. See *Standard Oil Company*
21 *versus State Board of Equalization* 1936 6 Cal 2d, 557
22 cite 559.

23 The Office of Tax Appeals, as an
24 administrative agency, is bound to follow and enforce
25 the laws under Article 3 Section 3.5 of the California

1 Constitution, and so lacks authority to provide
2 equitable relief without specific statutory authority.
3 Furthermore, OTA cannot create an exemption that is not
4 authorized by law. See Market Street Railway Company
5 versus State Board of Equalization, 1955, Cal Ap 2d, 87
6 pincite 96 through -- or 96 through 97.

7 Revenue and Taxation Code Section 6596,
8 provides tax relief for a person's reasonable reliance
9 on written advice from the Department under certain
10 specified conditions. Appellants did not receive and
11 has not presented evidence of written advice from the
12 Department in this matter.

13 As and administrative agency, OTA has no
14 authority under the California constitution to decline
15 to enforce the clear and unambiguous provisions of
16 Revenue and Taxation Code Section 6596, which explicitly
17 requires written advice to grant tax relief.

18 Under these facts, applying the Doctrine of
19 Equitable Estoppel to grant such relief would directly
20 contravene the clear language of Section 6596.

21 In summary, the mattresses Appellant sold do
22 not meet the definition of medicines under 6369. Nor
23 were they sold or dispensed under any exempt
24 circumstances. Therefore, Appellant is liable for
25 additional tax on a disallowed claimed non-taxable

1 sales.

2 Furthermore, the August 3rd, 2006, Notice of
3 Determination was timely issued under valid waivers of
4 limitation, and the Doctrine of Equitable Estoppel does
5 not apply. Since Appellant has not otherwise disputed
6 the audit methodology or the audited measure, no
7 adjustments to the Department's timely issued audit
8 determination is warranted.

9 For these reasons, we request the appeal be
10 denied.

11 Thank you.

12 JUDGE KWEE: This is Judge Kwee. Thank you. And
13 for -- I did have a quick follow-up question on the
14 issue of the timeliness. I understand the Appellant's
15 position is that CDTFA did not follow Regulation 1698.5,
16 and the CDTFA's position is that they did follow the
17 Regulation, and also, even if they didn't, that the --
18 this is an audit procedure regulation not a valid -- and
19 the waiver was still valid, like, a two-pronged
20 position; is that correct:

21 MS. JACOBS: That is correct.

22 JUDGE KWEE: Okay. This is Judge Kwee. And just
23 for clarification for the proposition that the CDTFA did
24 follow its regulation, I understand the CDTFA was citing
25 to the 414Z comments. The 79G comments -- letter and

1 the form 836A Report of Discussion. Is -- was that
2 correct, or was I missing some documents?

3 MS. JACOBS: No. That's correct.

4 JUDGE KWEE: Okay. I don't see the 79G letter in
5 the CDTFA's exhibit list, or I'm not sure if I missed
6 it.

7 MS. JACOBS: I can direct you to it. Just a
8 second. This is Amanda Jacobs. 79G. Pardon me.

9 It's found in -- it's Exhibit C, subfolder
10 correspondence, subfolder letters, and then it's
11 titled -- it has a long string of numbers, but the last
12 three are 79G.

13 JUDGE KWEE. Okay this is Judge Kwee. I -- I see
14 that now, and that is the letter dated March 18th, 2016,
15 signed by Karen Chavez, the DPA. Is that the same
16 letter that the exhibit is looking at?

17 MS. JACOBS: Yes.

18 JUDGE KWEE: Okay. Because I -- I just want to
19 make sure the dates are right because I was looking at
20 the 836A and that one appeared to be signed after the
21 waivers of limitation, but I believe this form does look
22 like it was signed before the waivers of limitation.

23 I will turn it over to the taxpayer to see if
24 they want to address the CDTFA's --

25 MS. JACOBS: I wanted to know because the 836A

1 was -- is just -- we're just citing to that to show that
2 Karen Chavez attended the ten-day discussion. She
3 attended the ten-day. We're not trying to use the date
4 or I'm -- it just -- it says represented by the DPA, if
5 that makes sense.

6 JUDGE KWEE: Okay. Yes, I understand.

7 And I will just turn it over to Appellant's
8 representative because I'm not sure that they have had
9 an opportunity to address the contention that the CDTFA
10 did follow their audit regulation.

11 MR. BRUDIGAN: Thank you, your Honor. This is
12 Malcolm Brudigan.

13 Just one moment here. I'm taking a look at
14 this letter.

15 So the requirement in the Regulation is quite
16 clear. It says that supervisory approval will be
17 documented. And here I don't see where this letter is
18 showing that the Statute of Limitations that a waiver
19 was -- approval was given.

20 And it seems like that Karen Chavez did
21 attend this ten-day office discussion, but that was held
22 on May 5th, and so her involvement came after both
23 Statute of Limitation waiver -- the waivers were both
24 signed, the first one on the 22nd, and then the second
25 was also on the 5th of May.

1 So I guess maybe -- maybe the Department can
2 point to where the supervisory approval is documented.
3 I mean, if it's -- otherwise, if this letter is -- is
4 the only proof, then it's speculative that approval was
5 given, or we're assuming that that's the case. So
6 that's -- yeah.

7 JUDGE KWEE: Okay. Thank you. This is Judge Kwee.

8 So I think, like, there's just a dispute over
9 what is meant by documented did indeed file. I'm not
10 sure. It gets into a back and forth over that
11 definition.

12 But I did have a separate question for
13 Appellant on the 6098.5, because it's -- the title of
14 the Regulation is "Audit Procedures," and then it says
15 this regulation provides taxpayers and Board staff with
16 the necessary procedures and guidance to facilitate a
17 sufficient and timely completion of an audit. And if
18 you look at the reference notes and authorities, it
19 doesn't cite 6488 as a reference -- as a reference. So
20 it doesn't seem like it -- it's interpreting the waiver
21 requirements or the timeliness of the NOD aspect. And
22 I'm wondering if Appellant has any statement of
23 regulatory intent or evidence from the rule-making file
24 which would indicate that the regulation did intend to
25 interpret the -- the timeframe for a waiver and

1 extension of a waiver in the event the CDTFA didn't get
2 supervisorial approval.

3 MR. BRUDIGAN: This is Malcolm Brudigan.

4 We don't have any regulatory history, but I'm
5 just going off the plain language of the statute itself.
6 I mean, it talks about the waiver limitation, and this
7 is a regulation that the -- the Department created
8 itself. And in that first part you read, it does say
9 that these are the necessary procedures. It doesn't
10 sound like they are optional for the Department to
11 follow. And it created this regulation, and now it
12 seems they don't want to necessarily follow it when the
13 language is pretty unambiguous that these procedures are
14 required, and one of those requirements is that the
15 supervisor's approval will be documented, and I don't
16 think that this letter that the Department has pointed
17 us to is showing us that. It's really a secondary
18 assumption that this letter represents that some sort of
19 approval happened behind the scenes. And so there still
20 is no adequate documentation to comply with this
21 regulation.

22 JUDGE KWEE: Okay. Thank you. Judge Kwee.

23 And I just wanted to make sure I was
24 following fully -- I was moving down to the issue to
25 whether this was exempt.

1 And from my understanding, the Appellant's
2 position is that this is an exempt medicine on the basis
3 of subdivision (a)(9)(b), which is any substance or
4 preparation continued for use by external or internal
5 application to the human body and the diagnosis here
6 mitigation, treatment, or prevention of disease and
7 which is commonly recognized as a substance or
8 preparation intended for that use; is that correct? Is
9 that the -- that the prong that Appellant is relying on
10 for this exemption?

11 MR. BRUDIGAN: This is Malcolm Brudigan.

12 Yeah, the prong is in sub -- I'm sorry, it's
13 in subdivision B of Section 6369, or it's also located
14 in the Regulation 1591(a)(9)(b). That's the provision
15 any substance or preparation intended for use by
16 external or internal application to the human body.
17 That's the -- the part. Was that your question? I'm
18 sorry.

19 JUDGE KWEE: This is Judge Kwee.

20 Yes, that was my question. And I just wanted
21 to follow up. Was there any dispute on whether or not
22 that this -- well, okay. So this is -- so then you are
23 not alleging this is -- or contending that this is
24 subdivision (a)(9)(a), basically approved by the Food
25 and Drug Administration? That's correct. You are just

1 looking at subdivision (b)?

2 MR. BRUDIGAN: That's correct, your Honor. This is
3 Malcolm Brudigan.

4 JUDGE KWEE: Okay. This is Judge Kwee. Thank you.

5 As far as the specific -- so there's the
6 six -- the six prongs that on which transaction of
7 medicine can be furnished in that manner. And my
8 understanding was that Appellant was looking at
9 6369(a)(2), the second prong, which was furnished by a
10 licensed physician, surgeon, dentist, a podiatrist, his
11 or her own patient for the treatment of the patient; is
12 that correct?

13 MR. BRUDIGAN: This is Malcolm Brudigan.

14 Yes, your Honor. That is the condition that we
15 contend the Appellant satisfied.

16 JUDGE KWEE: Okay. And this is Judge Kwee.

17 So it seems that was referring to when it's
18 furnished by a licensed physician or surgeon, and I'm
19 not sure Appellant is a mattresses store. So I'm just
20 curious how -- how that interplay works out. Or I'm not
21 sure if they are -- if there's evidence they are
22 licensed in some manner as a doctor podiatrist. Or I'm
23 not I'm sure if you want to address that.

24 MR. BRUDIGAN: This is Malcolm Brudigan.

25 Yes, your Honor. So the reason why this applies to

1 the Appellant is because the definition of "furnish"
2 which is provided for in the same regulation, which is
3 Section 1591 under the definition subdivision (a)(3),
4 furnish means to supply by any means by sale or
5 otherwise.

6 So what we're seeing here is that the
7 Appellant -- but for the Appellants, the doctors could
8 not have these prescriptions furnished to their
9 patients. And so the Appellant is falling under any
10 means or otherwise of that definition.

11 JUDGE KWEE: This is Judge Kwee.

12 So, yeah, I guess. I was just having a --
13 well, comparing the trappings of subdivision, one which
14 is prescribed for the treatment of a human being by a
15 person authorized to prescribe medicine. It seems like,
16 this is being sold under prescription. I guess I was
17 just trying to distinguish why -- why this wouldn't be
18 considered being prescribed for the treatment of a human
19 being because my understanding was that they were
20 prescriptions being issued, and then the issue with the
21 (a)(1) prong was that it has to be dispensed on the
22 prescription filled by a registered pharmacist, which, I
23 guess, that would be -- with your client not been a
24 pharmacist, I guess I was trying to distinguish between
25 furnished by licensed physician and prescribed for the

1 treatment of a human being. It seems the prescription
2 is more the (a)(1) prong, but I see your position. I'm
3 not sure. You can clarify that if you want.

4 MR. BRUDIGAN: Malcolm Brudigan. Thank you, your
5 Honor.

6 Yeah. What -- the reason why "furnish"
7 applies here is because the Department's own guidance
8 has really clarified this point in a tax annotation.

9 And, actually, we provided this as an exhibit
10 in our reply brief. It's annotation 425.0295, and it's
11 Exhibit 8 in our reply brief.

12 And really, if you look at the last page
13 under "Tax Consequences" -- Section C, it's called "Tax
14 Consequences." This shows that the definition of
15 "furnished" it does not matter that the vendor
16 themselves is a licensed medical professional. It's not
17 a requirement to satisfy that condition.

18 JUDGE KWEE: This is Judge Kwee.

19 Yes, I did see that annotation, and the only
20 thing I was looking at there is that it's pertaining to
21 an orthotic or prosthetic device. And then the statute
22 has the special -- the special application to tax for
23 those types of devices, and it says that for these
24 purposes furnished to the written order of a physician
25 or podiatrist shall be deemed to be dispensed on a

1 prescription whether or not other it's furnished by a
2 registered pharmacist. I wasn't sure how that
3 interplayed with the annotation. But I don't want to
4 get too hung up on -- on that language.

5 I did have one other question for Appellant,
6 and that was on the third issue, the equitable estoppel
7 argument. And, I guess, just the concern that I was
8 looking at, I was hoping, maybe, you could address this
9 because we have the -- the legislature has enacted that
10 6596, which requires written advice in order to relieve
11 taxes, interest, and penalties. It seems equitable
12 estoppel is requesting relief from taxes, interest, and
13 penalties based on oral advice from CDTFA. And I am
14 wondering would that contravene or would that go against
15 the statute to allow relief based on oral advice when we
16 have a statute which specifically requires written
17 advice?

18 I'm wondering if the Appellant would like to
19 briefly address the potential conflict there?

20 MR. BRUDIGAN: Thank you, your Honor.

21 I don't think it would contravene the
22 statute, and, I mean, the general doctrine of equitable
23 of estoppel was meant to cover all circumstances of
24 unfairness when someone has detrimentally relied on
25 something that the communicator, in this case, the

1 Department, you know, what they are apprised of.

2 So they are really going at two different
3 goals, and just separately the issue of equitable
4 estoppel. The Department is able to grant relief,
5 contrary what the Department had -- had said. I wanted
6 to make that clear. I wasn't sure if that was an issue,
7 but we actually cited a few cases where the OTA -- this
8 is in our Reply Brief, footnote 14, we cited to a few
9 instances where the OTA itself evaluated a taxpayer's
10 claim under equitable estoppel. And there the OTA
11 didn't seem to find any sort of conflict between this
12 general equitable doctrine and the specific tax statute
13 where written advice is involved.

14 JUDGE KWEE: This is Judge Kwee. Thank you very
15 much.

16 And at this point, I would like to turn it
17 over to the panel to see if my panel members have
18 questions of either party.

19 I'll start with Judge Aldrich. Judge
20 Aldrich, do you have any?

21 JUDGE ALDRICH: Yeah. I have couple for Appellant.

22 So in your opening, you mentioned that
23 Appellant took multiple steps. Just so I have it clear
24 what those steps were. It sounds like they got the
25 notice from the supplier, and then made a telephone call

1 to the BOE, and then strictly followed the advice from
2 the telephone call.

3 Were there any other steps that you'd like to
4 highlight?

5 MR. BRUDIGAN: Yeah. I think the main step is that
6 they reported their taxes this way for 30 quarters for
7 this, and there were no issues at all. I mean, they
8 were following this advice for years and no problems had
9 occurred. And, you know, because they conducted with
10 due diligence and there weren't any issues with the
11 Department for that long, they didn't see any reason to
12 change the way things were being done.

13 JUDGE ALDRICH: Okay. And then, just to get some
14 clarification on the waivers issue.

15 So I see that the first waiver was executed
16 March 24th, 2016, and the second waiver was executed
17 May 5th, 2016. And so you -- in your exemplar, you
18 emphasize two portions of Regulation 1698.5, one being
19 information to indicate an understatement, two, the
20 supervisor approval.

21 And is it -- your contention that the -- both
22 of these waivers fail on both points, or the first
23 waiver fails, second waiver doesn't? Could you clarify
24 that.

25 MR. BRUDIGAN: Sure. Our position -- this is

1 Malcolm Brudigan.

2 Our position is both the waivers fail on both
3 points. And really it just comes back to these being
4 two requirements that the Department is required to
5 follow. They cannot hide from their own regulations
6 just because they weren't necessarily or very clearly
7 interpreting the Statute of Limitation Statute. I mean,
8 well-established case law under a Yamaha Corp v. State
9 Board of Equalization shows that an agency that has
10 enacted its own regulation, it must follow those as if
11 it's the law.

12 JUDGE KWEE: Judge Aldrich, did you have any
13 further questions before I go over to --

14 JUDGE ALDRICH: Yeah. One brief one.

15 So if we assume that the waivers fail, what,
16 if any, authority exists to grant the requested relief
17 of invalidating the waiver?

18 MR. BRUDIGAN: If the waivers are invalidated, as
19 they should be, then that the first two quarters at
20 issue, the limitations period ran because the decision
21 and recommendation -- or I mean, the Notice of
22 Assessment was not issued until August 3rd, 2016. So if
23 we go back three years to August 3rd, 2013, that the
24 first two -- the tax return for the first two quarters
25 were -- were filed in April and July.

1 And so the relief is that those two periods,
2 that the assessment is untimely as to those two periods.

3 JUDGE KWEE: Okay.

4 JUDGE ALDRICH: I'm going to turn it back over to
5 Judge Kwee.

6 JUDGE KWEE: I'll -- just -- I'll go over to Judge
7 Long. Judge Long, do you have any questions for
8 anybody?

9 JUDGE LONG: This is Judge Long. I do have few
10 questions for Appellant.

11 First, with respect to the external
12 application to the human body, to be clear, we're
13 talking about laying down on a mattresses; right?

14 MR. BRUDIGAN: This is Malcolm Brudigan.
15 That's correct, your Honor.

16 JUDGE LONG: This is Judge Long.

17 So, when a person -- it's your contention
18 when a person lays down on the mattresses, that the
19 mattresses is applied to the human body?

20 MR. BRUDIGAN: This is Malcolm Brudigan.

21 Yes, that's correct. That's our contention.

22 JUDGE LONG: Okay. Thank you. This is Judge Long.

23 I just want to verify with respect to
24 annotation 425.0295, is there any dispute that the
25 orthotics discussed in the annotation is specifically

1 exempted from tax?

2 MR. BRUDIGAN: (Audio distortion)

3 JUDGE LONG: And is it -- this is Judge Long.

4 And is there any dispute that the mattresses
5 for sale in Appellant's case are not enumerated in
6 either the regulation of the statute as exempt from tax?

7 MR. BRUDIGAN: This is Malcolm Brudigan.

8 That's correct, they are not specifically
9 enumerated. They fall under the broad definition.

10 JUDGE LONG: Okay. Thank you. I have no more
11 questions.

12 JUDGE KWEE: This is Judge Kwee.

13 I believe Judge Aldrich has another question
14 about the 414Z.

15 Judge Aldrich, did you want to -- do you have
16 a question?

17 JUDGE ALDRICH: Sure.

18 So the question is for the Department. I
19 believe we determined who the district principal auditor
20 was based off the of the 79G, but I saw a couple other
21 names on the 414G. So one was Sheri Checchi -- sorry if
22 I butcher these names -- and one's Christa Spinali, and
23 one's Miyon Byun.

24 Could you clarify what their positions and
25 slash titles were at the time of the audit, if it's

1 known?

2 MS. JACOBS: Sure. So, Sharon -- Karen Chavez was
3 the district principal auditor. Sheri Checchi was the
4 supervising tax auditor. And let me open a 414Z, real
5 quickly. Miyon Byun was the -- shoot -- was the auditor
6 in the case. And then Christa Spinali was a senior -- I
7 believe she was a senior tax auditor; is that -- is that
8 right, Jason?

9 MR. PARKER: She was a -- I believe she was a
10 business tax specialist one, which is a non-supervisory
11 role.

12 MS. JACOBS: Thank you.

13 JUDGE ALDRICH: Thank you.

14 JUDGE KWEE: Okay. This is Judge Kwee.

15 So with that said, are there any other
16 questions from either panel members before we proceed to
17 closing argument?

18 It looks like both judges are shaking their
19 heads no.

20 MR. MERTEN: Your Honor, may I make a statement in
21 connection with the procedural argument?

22 JUDGE KWEE: Yes. This is Judge Kwee.

23 You may proceed.

24 MR. MERTEN: So just as a clarification, the
25 procedural argument and really all three of these

1 arguments were clearly set forth in the August initial
2 opening brief by the Appellant August 2019, so over a
3 year ago. In response to this procedural argument, the
4 CDTFA did not point to anything in the audit file that
5 they had met any of the requirements in the regulation
6 were fulfilled with the procedural waiver front, and
7 instead just stated there was no support.

8 In response to that in Appellant's reply
9 brief, it was indicated again it's clearly in the
10 regulation, and that's where the requirements are found.

11 So bringing up these arguments on the day of
12 hearing, if in any way the panel is inclined to consider
13 these arguments about the speculative nature of what the
14 supervisors may have been trying to point out or put
15 into the audit file, even though it's not clearly
16 stated, Appellants would respectfully request the
17 ability to provide post hearing briefing on that,
18 because it is (audio distortion).

19 JUDGE KWEE: This is Judge Kwee. And just to
20 clarify, the scope of request for post-hearing briefing,
21 is it limited to the issue on, one, whether or not there
22 was documentation to support supervisor approval? Is
23 that the scope of the request?

24 MR. MERTEN: Yes, your Honor. If there's anything
25 else that would be helpful to the panel, of course,

1 Appellant would be happy to provide post-hearing
2 briefing as well, but that specifically is what this
3 request concerns.

4 JUDGE KWEE: Okay. This is Judge Kwee. I'll turn
5 it to CDTFA.

6 I will first -- I think Appellant is saying
7 that this is a new argument that might hadn't been
8 brought up by CDTFA before.

9 Does CDTFA have a position on that or --
10 and/or any objection to additional briefing to allow
11 them to address that -- this argument?

12 MS. JACOBS: I -- I don't think we have any
13 objections to post-hearing briefings, if that's what OTA
14 deems is necessary.

15 As -- as with regard to this being a
16 brand-new argument, do you want to speak to that,
17 Monica?

18 MS. SILVA: We did provide in our response brief,
19 it is new argument that was made, and we did reference
20 it, in our response brief, so, I don't think this is all
21 new. It had the same position with respect to the
22 waivers.

23 MS. JACOBS: I'd also like to point out that the
24 evidence has been in the file since our initial advice.
25 We have had the same Exhibit C in the file, you know,

1 since -- since our initial advice. So all the evidence
2 -- all the evidence we are referencing is in there.

3 JUDGE KWEE: Okay. This is Judge Kwee.

4 So, at this point, I'm not going to order
5 additional briefing, but then if, after reviewing the
6 file, OTA determines additional briefing would be
7 helpful, I will send out an order contacting the
8 parties. But at this point, we're not going to be
9 sending out an additional briefing order.

10 MR. MERTEN: (Audio distortion) -- response to that
11 issue, additional briefing.

12 Just to point out in the -- in the
13 Department's brief, all that is indicated on the very
14 last page on page 3, it states that the Department has
15 also included the Notice of Determination, Exhibit B,
16 and we added work Exhibit C associated with this appeal
17 and they are now trying to point to separate pages,
18 specifically, in that audit file working papers, and
19 that was not at all directly addressed in the brief or
20 cited to in the (audio distortion) argument.

21 Just as it -- as the issues going through
22 that, is taken into consideration.

23 Thank you.

24 JUDGE KWEE: This is Judge Kwee, and I will take
25 that into consideration when I review the file.

1 And in connection with deciding, you know, at
2 this point I would like to turn it over to the parties
3 for closing arguments. You each have 10 minutes.

4 I will start with Appellant. You may
5 proceed.

6

7

CLOSING STATEMENT

8

MR. BRUDIGAN: Thank you, your Honor. This is
9 Malcolm Brudigan.

10

So to recap, there are three independent
11 reasons why the Department's assessment is invalid.

12

And in the first one, it's because they
13 didn't execute a proper Statute of Limitations waiver
14 and the Department seems to want to get away from the
15 requirements in their in own regulation.

16

But, as I had mentioned in response to one of
17 the questions from the panel, case law provides that
18 regulations that are codified by the agency must be
19 followed by that agency. And the well-known Supreme
20 Court case, Yamaha Corp of America v. State Board of
21 Equalization, which is 19 Cal 4th 1, pincited 7
22 establishes that principle. They can't now get away
23 from the very clear requirement that this approval will
24 be documented. Evidence of an understatement will exist
25 before the limitations waiver is sought. And here they

1 just haven't clearly established that.

2 Now, as to how the prescription mattresses
3 satisfy the definition of medicines, I just to want to
4 pull up the statutory definition really quick to make
5 clear the provisions we are relying on. Just bear with
6 me.

7 So here, so we are relying on the broad
8 definition, and really -- we see this as having two
9 parts to it, and, really, the first part is any
10 substance or preparation intended for use by external or
11 internal application. And here, we think the mattresses
12 easily satisfy this part. There's no doubt that the
13 mattress is a substance. It's a physical thing. I
14 mean, it's a very broad definition and it is applied to
15 the body when someone lays down on it.

16 Really, the critical piece of this definition
17 is the second part, and that's that the mattresses were
18 applied to the human body for the diagnosis, cure,
19 mitigation, treatment, or prevention of disease. And
20 here that's exactly what the prescription mattresses
21 sold by Mr. and Mrs. Atkins did. They were prescribed
22 by licensed professionals to prevent the very severe
23 ailments that came from various chemicals in the
24 mattresses. So this way, the mattress satisfied this
25 definition.

1 And I just wanted to clarify that the
2 definition in the statute is the same that is in the
3 regulation here (a)(9), and then, as Judge Kwee had
4 pointed out, this is the provision we are relying on.
5 So (a)(9) sub paragraph (b).

6 But I just wanted to also point out that when
7 the regulation goes on to define preparations and
8 substances, before that it actually says in addition to
9 the definition set forth in subdivision (9) of this
10 regulation, the term medicine means and includes the
11 following items. As it goes on to explain or, you know,
12 names specific preparations and similar substances, it
13 actually is saying that those were all in addition to
14 the general definition provided in (a)(9) which we are
15 relying on.

16 So just because the mattresses --
17 prescription mattresses don't seem to fall within this
18 sub definition of preparations and similar substances,
19 the statute provides a broader definition that goes
20 beyond that. So I just wanted to point that out to the
21 panel to make clear which part of the definition we're
22 relying on.

23 And I -- and wanted to come back to the
24 second piece of the prescription medicine exemption, and
25 that's -- has to do with the conditions that must be

1 satisfied. And, again, I just wanted -- this is an
2 issue that was bought up for the first time by the
3 Department on appeal, and so they really have the burden
4 of establishing this under the OTA's decision in the
5 matter appeal of Praxair, because when a new matter is
6 presented and it requires difference evidence, the
7 burden shifts to the Department, and here they have not
8 met that burden. And that's really shown because of the
9 broad definition of "furnish" under the regulation.
10 Their position that medicine that qualified under this
11 exemption can only come from a licensed medical
12 professional is just too narrow, and it's not supported
13 by the direct language in the regulation.

14 And to further back it up, I just want to
15 reiterate that the tax annotation independent of the
16 fact that the medical foot device had a specific
17 enumerated exemption. That's a separate part of the
18 statute. And here it clearly established that the time
19 conditions related to furnishing medicines, furnishing
20 prescriptions by a licensed medical professional, that
21 condition would be established when it wasn't provided
22 by a licensed medical professional. And here that's the
23 same situation with our vendor. I just want to do
24 clarify that piece of the prescription medicine
25 exemption.

1 And then on the Equitable Estoppel point, the
2 Department seems to think that the OTA cannot grant
3 equitable relief and it cited one case in its brief
4 Standard Oil, but it didn't explain how that case stood
5 for that proposition. And as we explained in our reply
6 brief, it actually doesn't talk about equitable estoppel
7 at all, and, in fact, we cite in our reply in footnote
8 14 several instances of the OTA and then also for the
9 BOE before that considering taxpayers' claims under the
10 general equitable estoppel doctrine. So this isn't a
11 new thing.

12 And I wanted to want address another point
13 that administrative agencies can't apply equitable
14 estoppel, and that's -- that's just wrong. It's
15 actually not an inherently judicial power. Agencies and
16 courts are empowered to apply it. And in support of
17 that proposition, I wanted to cite *Lance v. McMahon*,
18 which is 39 Cal 3d 393, and the specific pin I am
19 referring to is 402 to 406. And in that case it
20 established that ALJs of the Department of Social
21 Services were authorized to estop counties from
22 recouping overpayments when welfare recipients had
23 argued that the County failed to advise them of various
24 procedural requirements.

25 So I Just wanted to make clear that the OTA

1 does have the power to do that.

2 And then I just -- and finally, I just wanted
3 reiterate that Mr. and Mrs. Atkins had been doing it
4 this way for many quarters. The idea that the
5 Department all of a sudden identified this as a problem,
6 and that was the basis for the information that some
7 understatement taxes existed doesn't really make sense.
8 I mean, they had been doing this for 30 quarters we --
9 we found. And at bottom, Mr. and Mrs. Atkins had
10 detrimentally relied on the Department's affirmative
11 advice and they conducted reasonable due diligence and
12 they were trying to comply with the law, so they
13 shouldn't been punished due to the Department's
14 erroneous advice.

15 And for these reasons, unless the panel has
16 further questions, Mr. and Mrs. Atkins respectfully
17 request reversal of the D&R in its entirety.

18 Thank you.

19 JUDGE KWEE: This is Judge Kwee. And before I turn
20 it over to CDTFA for their closing presentation, I just
21 had a quick clarification.

22 I think Appellant has been referring to Mr.
23 and Mrs. Atkins, but my understanding was the liability
24 was only that of Romie Atkins; is that correct? Or am I
25 missing the taxpayer -- misunderstanding the taxpayer at

1 issue.

2 MR. BRUDIGAN: That's correct. It's technically
3 Mrs. Atkins -- Romie Atkins, but they operated as a
4 husband and wife team, so that's how we have thought
5 about them. So, yes, it's technically Romie Atkins.

6 JUDGE KWEE: Okay.

7 MR. BRUDIGAN: Sorry for that.

8 MR. MERTEN: Sorry. Mr. Atkins signed a POA so
9 that -- in connection with his involvement on behalf of
10 his wife.

11 JUDGE KWEE: Judge Kwee. Thank you very much for
12 your clarification. Got it.

13 Ill now turn it to over CDTFA for their
14 closing presentation -- closing arguments.

15 You have ten minutes. Please proceed.

16 MS. JACOBS: Amanda Jacobs, CDTFA.

17 Before my conclusion, I wanted to address
18 Appellant's first mention of Praxair here at this
19 hearing. While it is a precedential decision, the facts
20 are clearly different from the facts before us today.

21 The Department here has consistently
22 maintained that the mattresses are not medicines. In
23 the Department's response to Appellant's Opening Brief,
24 the Department included the Appellant -- included the
25 argument regarding dispensing medicines.

1 This is not a new argument at hearing, and to
2 the extent that Appellant stated there was a shifting of
3 a burden, there is no shifting of a burden here.

4

5 CLOSING STATEMENT

6 Now, to my conclusion, the mattresses
7 Appellant sold do not meet the definition of medicines
8 under Section 6369, and they were not sold or dispensed
9 according to statutory requirements. The August 3rd,
10 2016, Notice of Determination was timely issued under
11 valid waivers of limitation and the Doctrine of
12 Equitable Estoppel does not the apply. Based on the
13 evidence, no adjustments to the Department's timely
14 issued audit discrimination is warranted. We request
15 the appeal be denied.

16 Thank you.

17 JUDGE KWEE: This is Judge Kwee.

18 Before we conclude the proceedings, I'll turn
19 it over to the panel one last time.

20 Judge Aldrich, do you have any final
21 question?

22 JUDGE ALDRICH: I don't have any further questions.
23 Thank you.

24 JUDGE KWEE: Okay. Judge Long, did you have
25 anything further before we conclude?

1 JUDGE LONG: No further questions. Thanks.

2 MR. MERTEN: Your Honor, because we didn't use all
3 of our time in our closing argument, we have just one
4 point to make in response to that Praxair point.

5 Are we permitted to make that?

6 JUDGE KWEE: This is Judge Kwee.

7 Yes, Appellant may proceed with their final
8 remarks and conclusion.

9 MR. MERTEN: Go ahead, Malcolm.

10 MR. BRUDIGAN: Yes. Yeah. So I just wanted to
11 point out that it is a new issue that was raised on
12 appeal. In the D&R it shows -- it clearly states that
13 there was only one issue at play, and that was the issue
14 of whether the definition of medicines was satisfied.
15 And I want to share my screen so I can show a portion of
16 the D&R just very briefly. Sorry.

17 So here we can see in the Department's
18 footnote that the Department did not contend that the
19 prescriptions provided were invalid for any reason, they
20 are not at issue -- it was not at issue that they were
21 provided by a licensed medical doctor or pharmacist.

22 MR. MERTEN: As one example. Yeah. Very clearly a
23 new issue.

24 Thank you, your Honor.

25 JUDGE KWEE: Okay. Thank you.

1 You may stop sharing your screen when you are
2 ready, and I will proceed with the closing detail.

3 Okay. Thank you.

4 Then we are ready to conclude this hearing,
5 and this case is submitted today -- today -- sorry --
6 tuesday, October 13th, 2020, and the record is now
7 closed.

8 I'd like to thank everyone for coming in
9 today, and the judges will meet and decide your case
10 later on, and we will send a written opinion of our
11 decision within 100 days of today's date.

12 So the hearings are now adjourned for the day
13 and will resume on the 15th.

14 Thank you, everyone. Bye.

15 (Off the record the at 12:00 p.m.)

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Dorothy M. Simpson
CSR No. 14323