

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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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: California Department of Tax  
and Fee Administration  
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 supervisorial 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

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

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11

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

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

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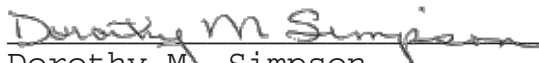
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