OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 19044588
	) CDTFA Account No. 101-605445
THERATEST LABORATORIES, INC.	) CDTFA Case ID 910228
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Paul Raymond, Esq. Elaine Minaltowski, General Manager Marius Teodorescu, President and CEO[1]
For Respondent:	Chad Bacchus, Tax Counsel III Scott Claremon, Tax Counsel IV Jason Parker, Chief of Headquarters Ops.

M. GEARY, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Theratest Laboratories, Inc. (appellant) appeals a decision issued by the California Department of Tax and Fee Administration (respondent) denying appellant's petition for redetermination of the July 16, 2015 Notice of Determination (NOD), of $338,022.58 in tax, and applicable interest, for the period July 1, 2010, through March 31, 2014 (liability period).[2]

[1] Marius Teodorescu testified that he was president and chief executive officer (CEO) of appellant during the liability period. It is unclear whether he continues to perform in that capacity.

[2] Sales and use taxes (and other business taxes and fees) were formerly administered by the State Board of Equalization (BOE). In 2017, the California Legislature transferred functions of the BOE relevant to this case to respondent. (Gov. Code, § 15570.22.) The effective date of the transfer of all but adjudicatory functions was July 1, 2017. (Adjudicatory functions were transferred to the Office of Tax Appeals effective January 1, 2018.) Thus, when referring to events that occurred before July 1, 2017, "respondent" shall refer to the BOE.

Office of Tax Appeals Administrative Law Judges Daniel K. Cho, Nguyen Dang, and Michael F. Geary held an electronic oral hearing in this matter on July 21, 2020.[3] At the conclusion of the hearing, the parties submitted the matter for decision, and we closed the record.

ISSUE

Did appellant have a duty to collect use tax from its California customers during the liability period and to remit that tax to respondent?

FACTUAL FINDINGS

1. Appellant is an Illinois corporation.
2. Appellant's primary revenue stream is from the sale of medical test kits and related consumables.[4] The test kits are used with equipment, including pipetting machines, microplate readers, and microplate washers, which are usually leased or otherwise provided by appellant to its customers.
3. Some of appellant's customers have their own equipment, but more often appellant provides the equipment to its customers. Appellant's typical agreement with its customer requires the customer to use appellant's test kits exclusively, and appellant acknowledges that the price of test kits sold to customers who are not using appellant's equipment is less than the price charged to customers who are using appellant's equipment.
4. Appellant's employees traveled to California to set up appellant's equipment for its customers and train the customers' staff who would be operating the equipment (technicians). Appellant's agreements also required it to provide additional training to new technicians as often as once per year. Appellant also maintained its equipment, which included annual maintenance on some equipment.
5. Prior to May 20, 2010, respondent contacted appellant regarding its sales of tangible personal property (TPP) to California customers.
6. In response to the contact initiated by respondent, on or about May 20, 2010, appellant submitted a completed "Application for Seller's Permit," which Marius Teodorescu, the

[3] This matter had been set for hearing in Cerritos. However, in an effort to provide for the safety of participants and observers during the COVID-19 pandemic, the judges, parties, and witnesses participated, and others were allowed to observe, via audio and video feeds using web-based applications.

[4] In his testimony, Marius Teodorescu referred to the test kits as tests for rheumatic disease.

president and CEO, Mihai Teodorescu, the vice-president of operations and chief operations officer, and Corina Dima, the vice-president of quality control, all signed. The application indicated that appellant began California business activities, consisting of the sale of automated pipetting machines, microplate readers, and microplate washers, on May 20, 2010. The application did not mention appellant's sales of test kits or related consumables.

7. Based on information provided by appellant, respondent determined that appellant was not required to hold a seller's permit because its application reported that appellant did not have a business location or inventory in California. Thus, respondent did not issue a seller's permit to appellant; instead, respondent issued to appellant a "Certificate of Registration – Use Tax" (Certificate) with an effective start date of May 20, 2010. The Certificate remained active during the entire liability period.
8. Appellant concluded that, regardless of the Certificate, it had no obligation to pay tax to respondent in connection with its sales to California customers. On that basis, appellant filed California sales and use tax returns (SUTRs) for each of the quarters within the liability period reporting no taxable sales in California.
9. Respondent audited appellant for the liability period and determined that appellant made sales of TPP to California customers during the liability period totaling $3,944,410 and that appellant had a duty to collect, report, and remit use tax measured by those sales.
10. On July 16, 2015, respondent issued an NOD to appellant for $338,022.58 tax, plus applicable interest.
11. Appellant filed a timely petition for redetermination disputing the NOD on the grounds that it had no obligation to collect and remit use tax in connection with its sales to California customers.
12. The parties participated in an appeals conference, and on February 28, 2019, respondent issued a decision rejecting appellant's argument and ordering the petition be denied and the NOD be redetermined without adjustment. This timely appeal followed.

DISCUSSION

California imposes sales tax on a retailer's retail sales of TPP in this state, unless the sale is exempt or excluded from tax. (R&TC, § 6051.) When sales tax does not apply, use tax applies to the storage, use, or other consumption of TPP purchased from any retailer for storage,

use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (R&TC, §§ 6201, 6401.) Generally, use tax is owed by the person who purchases the property for storage, use, or consumption in this state. (R&TC, § 6202(a).) However, out-of-state retailers who are engaged in business in this state have an obligation to collect and remit use tax from the purchaser on sales of TPP for use, storage, or consumption in this state. (R&TC, § 6203(a).)

A retailer is "engaged in business" in this state if it has a substantial nexus with the state. (R&TC, § 6203(c).)[5] According to R&TC section 6203(c)(2) and (3), and as relevant here, substantial nexus can be established by proof that the retailer has in this state agents or other representatives who sell, deliver, assemble, or install the retailer's products, or TPP that appellant leases for use here. In addition, holders of Certificates are also required to collect and remit use tax in the same manner as retailers engaged in business in this state, even if the Certificate holders are not otherwise so engaged. (Cal. Code Regs., tit. 18, § 1684(e);[6] see also *Appeal of B & D Litho, Inc.* (SBE Memo.) 2001 WL 1034733.)

Respondent concedes that use tax, not sales tax, applies because the sales in question occurred outside of California when appellant delivered the TPP to interstate carriers for ultimate delivery to the California customers. (See Com. Code, § 2401; Cal. Code Regs., tit. 18, §§ 1620(a)(2) and 1628(b)(3)(D).) Respondent asks us to sustain its action denying the petition for redetermination. It contends that its determination that appellant had a substantial nexus with California during the liability period is supported by appellant's physical presence in California, as demonstrated by the presence in California of appellant's equipment, which the customers leased from appellant and needed to use the test kits that provided appellant's primary revenue stream, and by the presence in California of appellant's employees, who set up the equipment, provided training to the technicians, and performed maintenance on at least some of appellant's equipment. In addition, respondent argues that, even without the clear evidence of appellant's physical presence in and nexus with California, the liability determination is supported by the

[5] Although the term "nexus" does not appear in R&TC section 6203 until the 2011 amendment, operative September 15, 2012, the physical presence requirement was the same throughout the liability period.

[6] California Code of Regulations, title 18, section 1684 has been amended several times since the beginning of the liability period. Our citations will be to the current version, which prescribes the extent to which it shall not be given retroactive effect. (See R&TC, § 7051.)

fact that appellant held the Certificate that required it to collect and remit use tax as if it was engaged in business in this state.

While appellant states in one of its written arguments that it disputes all of the conclusions reached in respondent's Decision, most of the operative facts, including those that we find above, were conceded by appellant, supported by appellant's witnesses, or otherwise established by respondent's evidence and essentially unopposed by appellant. Appellant does not dispute that the presence of its equipment in California at least facilitated its sales of TPP to customers in this state during the liability period totaling $3,944,410.[7] It does not dispute that it applied for a seller's permit, that respondent issued appellant a Certificate, or that respondent informed appellant that the Certificate required appellant to collect and remit use tax in connection with its sales to California customers.[8] Appellant does not dispute that it failed to remit the use tax. Finally, appellant does not dispute the audit methodology.

Relying on California Code of Regulations, title 18, (Regulation) section 1684(b)(2), appellant contends that its physical presence in California only gives rise to a rebuttable presumption that appellant is engaged in business in this state, and that the presumption is rebutted by evidence showing that appellant's physical presence here is "so slight that the United States Constitution prohibits this state from imposing a use tax collection duty on the retailer." Appellant asks us to grant the petition in full, arguing that during the liability period, it had no meaningful physical presence in, or any substantial nexus with, California. It asserts that it was not engaged in business in California and did not voluntarily consent to or undertake a use tax collection obligation. In essence, appellant asserts that respondent forced it to apply for a seller's permit through threat or misrepresentation, and when it inquired of respondent regarding cancellation of the Certificate shortly after the audit began, respondent informed appellant that the appellant could not cancel the Certificate because the account was then under audit. Appellant also contends that holding a Certificate alone does not require the retailer to collect and remit use tax because the retailer must also be engaged in business in the state. For all these

[7] Appellant's agreements required California customers who used appellant's equipment to use only appellant's test kits unless the customer obtained appellant's written consent to do otherwise.

[8] The cover letter from respondent, which accompanied the Certificate that was mailed to appellant on June 3, 2010, states, "If you deliver your product by common carrier from inventory located outside California, you are a seller liable for the collection of 'use tax' as opposed to 'sales tax'."

reasons, appellant contends that there was no reasonable, rational, and constitutional basis for the imposition of a use tax collection obligation on it.

There are three potential bases for a finding that appellant was engaged in business in California during the liability period: appellant's ownership of the equipment that it provided to its California customers to enable the customers to use appellant's test kits; the presence in this state of appellant's employees, who installed appellant's equipment at the customers' locations in California, maintained the equipment, and trained the technicians in the use of the equipment; and the Certificate. We will address each alleged basis below.

Regarding appellant's ownership of the equipment used by its customers in California, it is undisputed that appellant owned the equipment that most of its California customers used to process the test kits that appellant sold to those customers. The test kit prices appellant charged its customers who used appellant's equipment were higher than the prices charged to customers who did not use appellant's equipment. Lacking any other logical explanation, we conclude that this charge was compensation to appellant for the use of its equipment. Based on the evidence, we find that appellant leased the equipment to its California customers.[9] Any retailer deriving rentals from a lease of TPP located in this state is engaged in business in this state with respect to that lease. (R&TC, § 6203(c)(3).) We therefore conclude that appellant, a lessor of the TPP, was engaged in business in California with respect to those leases. Consequently, it was required to collect use tax from its California customers and remit that tax to the state. (R&TC, § 6203(a).) The use tax that appellant was required to collect constitutes a debt owed by appellant to the state. (R&TC, § 6204.)

Regarding appellant's physical presence in California, it is undisputed that appellant's employees set up the equipment and provided on-site training to the technicians. According to Marius Teodorescu, the installation and training would take three to four days, depending on the availability of the trainee. In addition, if the customer needed to replace its technician, appellant's staff would return to California to train the replacement, the only limitation being that training services included in the cost of the TPP was limited to the initial training and one additional training per year thereafter for the initial five-year term of the agreement. Furthermore, appellant's employees maintained the equipment owned by appellant. Marius

[9] For sales and use tax purposes, a lease is a temporary transfer of possession and control of TPP for consideration. (Cal. Code Regs, tit. 18, § 1660(a)(1).)

Teodorescu testified that the larger pieces of equipment required annual inspection and servicing, which was done by appellant's employees. The work done by appellant's employees in California was directly related to appellant's ability to establish, maintain, and grow a customer base in California. We conclude that the presence in California of appellant's staff to install and maintain its equipment and to train the technicians provides an additional basis for a finding that appellant was engaged in business in California during the liability period for all transactions and was thus required to collect and remit use tax to the state.

Finally, regarding the Certificate's validity, we first note that our jurisdiction is limited. Regulation section 30104(d) states that the Office of Tax Appeals does not have jurisdiction to consider whether appellant is entitled to a remedy for respondent's actual or alleged violation of any substantive or procedural right, unless the violation affects the adequacy of a notice, the validity of an action from which a timely appeal was made, or the amount at issue in the appeal. (See also *Appeals of Dauberger et al*. (82-SBE-082) 1982 WL 11759.) Here, notice and the amount of the determination are not disputed, and, as already explained, respondent's authority to audit and issue an NOD to appellant was not dependent on whether appellant held a seller's permit or Certificate. Even if this argument was a matter within our jurisdiction, we are not persuaded by the evidence that appellant's application for a seller's permit was involuntary. Compliance outreach is one of respondent's responsibilities. It is important that all who owe sales and use tax pay their fair share, but not all taxpayers are aware of their obligation. There is nothing in the evidence to show that respondent made inappropriate comments, threats or misrepresentations which forced appellant to submit the application. Even if, as appellant asserts, respondent indicated that it would audit appellant and determine a liability regardless of whether appellant submitted an application, we would not view such a statement as a threat. If respondent had a reasonable belief that appellant owed sales or use taxes to California – and the evidence before us demonstrates that it did – it would have been entirely appropriate for respondent to advise appellant to apply for a seller's permit or Certificate and to inform appellant that respondent had the authority to audit appellant regardless of an application. (R&TC, § 7054.) We find nothing unusual or inappropriate about respondent's initial contact with appellant. We also find that the Certificate was correctly issued to appellant and that it remained valid during the entire liability period.

We are not persuaded by Elaine Minaltowski's testimony that respondent told appellant that the Certificate could not be cancelled because appellant was being audited.[10] Even if such a statement had been made and appellant had relied on it by not requesting cancellation of the certificate, such reliance would not have affected the liability at issue here. Appellant did not make the alleged inquiry until after the liability period, and the cancellation of a Certificate is not retroactive. (*Appeal of B & D Litho, Inc., supra.)*

Based on the evidence, we find that respondent's issuance of the Certificate to appellant was proper, that the Certificate remained valid during the entire liability period, and that the Certificate provided a separate and independent basis for a finding that appellant had a duty to collect use tax from its California customers and remit that tax to the state, regardless of whether appellant was engaged in business in this state. (See Cal. Code Regs., tit. 18, § 1684(e)(2).) Although the above findings are dispositive of this appeal, we will further address some of appellant's arguments below.

Regarding appellant's nexus arguments, the evidence establishes at least two of the bases identified in our statute as sufficient to show that a retailer is engaged in business in California: appellant's employees were present in this state for the purpose of installing appellant's equipment (R&TC, § 6203(c)(2)); and appellant derived rentals from its leases of equipment to California customers (R&TC, § 6203(c)(3)).[11] Such evidence does not merely give rise to a rebuttable presumption that the retailer is engaged in business in this state, as appellant argues. It establishes that fact on two separate bases. Furthermore, the "rebuttable presumption" language found in Regulation section 1684 and relied upon by appellant is prefaced by the words, "Except as otherwise provided in this regulation." (See Cal. Code Reg., tit. 18, § 1684(b)(2).) Regulation section 1684(c) states, in pertinent part, that on and after September 15, 2012, a retailer is engaged in business in this state, as defined in R&TC section 6203, if the retailer: (1) owns or leases real or tangible personal property in California; (2) derives rentals from a lease of tangible personal property situated in California (under such circumstances the retailer is

[10] The law required that appellant remain registered with respondent as long as it had a physical presence in this state sufficient to establish a substantial nexus with this state. (See R&TC, § 6203; Cal. Code Reg., tit. 18, § 1684.) It would have been that continued nexus, not the pending audit, which would have prevented appellant from cancelling its Certificate.

[11] While there were three different versions of R&TC section 6203 operative at various times during the liability period, all versions contained these provisions.

required to collect the tax at the time rentals are paid by the lessee); or (3) has a person operating in California on the retailer's behalf for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property, or otherwise establishing or maintaining a market for the retailer's products.[12] Appellant's physical presence in this state satisfied all three criteria, including the establishment and maintenance of a market in California from appellant's products.[13]

None of appellant's cited case authorities are controlling here. They do not involve an interpretation of California law. Having concluded that appellant was engaged in business in California within the clear meaning of R&TC section 6203 and Regulation section 1684, the question of nexus, at least the question that is within our purview to address, is answered. To the extent appellant would have us conclude that the controlling California statute and regulation are unconstitutional, we note that OTA is precluded by the Constitution of the State of California from declaring a statute unenforceable or refusing to enforce the clear and unambiguous provisions of a statute, unless an appellate court has determined that the statute is unconstitutional. (Cal. Const., Art. III, § 3.5.)

Finally, appellant's argument that a duty to collect and remit use tax cannot arise solely by issuance of a Certificate to a retailer who is not otherwise engaged in business in California finds no support in the law. Retailers who are engaged in business in this state and make sales of TPP for storage, use, or consumption in this state are required to register with respondent, and to collect and remit use tax when due. (R&TC, § 6203(a); Cal. Cod. Regs., tit. 18, § 1684(a).) However, Regulation section 1684(e)(2) provides that a retailer *who is not engaged in business in this state* may apply for a Certificate, and, upon issuance of the Certificate, the retailer has the same obligations to collect and remit use tax as retailers who are engaged in business here. In effect, the retailer is voluntarily submitting to respondent's taxing jurisdiction, and respondent is entitled to rely on that submission, and to consider the retailer to be engaged in business in this state solely by virtue of the Certificate until the Certificate is cancelled.

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[12] The "rebuttable presumption" language is not in the earlier version of Regulation section 1684. However, that version does provide that any retailer deriving rentals from a lease of TPP situated in this state is a "retailer engaged in business in this state" and is required to collect the tax at the time rentals are paid by his lessee.

[13] Appellant's agreements for the use of its equipment for the typical five-year term required the customers to use only appellant's test kits with appellant's equipment. Thus, by providing, installing, and maintaining equipment for its California customers, and by training customers to use the equipment, appellant hoped to establish and maintain a market for its test kits for at least the 5-year term of the agreements.

HOLDING

Appellant had a duty to collect use tax from its California customers during the liability period and to remit that tax to respondent.

DISPOSITION

We sustain respondent's action denying the petition for redetermination.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

We concur:

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Nguyen Dang
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Nguyen Dang
Administrative Law Judge

DocuSigned by:
Daniel Cho
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Daniel K. Cho
Administrative Law Judge

Date Issued: 9/29/2020