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BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
POMONA VALLEY COMMUNITY) OTA NO. 20056171
HOSPITAL, LTD.,)
)
APPELLANT.)
)
_____)

Transcript of Virtual Proceedings,
taken in the State of California, commencing
at 1:04 p.m. and concluding at 2:13 p.m.,
on Wednesday, April 21, 2021, reported by
Ernalyn M. Alonzo, Hearing Reporter, in and
for the State of California.

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APPEARANCES:

Panel Lead: ALJ SUZANNE BROWN

Panel Members: ALJ JOSHUA LAMBERT
ALJ ANDREW WONG

For the Appellant: BRIAN NISENHOLTZ
STAN PINCURA

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX AND
FEE ADMINISTRATION

JARRETT NOBLE
RANDY SUAZO
SCOTT CLAREMON

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-21 were received at page 9.)

(Department's Exhibits A-G were received at page 9.)

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California; Wednesday, April 21, 2021

1:04 p.m.

JUDGE BROWN: And we are now on the record for the appeal of Pomona Valley Community Hospital, LTD, OTA Case Number 20056171. Today is Wednesday April 21st, 2021, and it is 1:04 p.m. We are holding this hearing by video conference, but the location, for the record, is technically Cerritos, California. This hearing is before Office of Tax Appeals or OTA. OTA is an independent agency that is separate from the California Department of Tax and Fee Administration.

My name is Suzanne Brown. I'm the lead Administrative Law Judge who will be conducting the hearing for this case. On today's panel, in addition to myself, we have Judge Andrew Wong and Judge Josh Lambert. While I am the lead ALJ for purposes of conducting this hearing, my co-panelists and I are co-equal decision makers, and they may ask questions of either party during the hearing at any time. Further, our panel of three ALJs will decide all of the issues presented to us, and each of us will have an equal vote in making those decisions. Also present is our stenographer, Ms. Alonzo.

Next, I will ask the parties to identify themselves for the record. I will start with the

1 Appellants. Could each of the participants on behalf of
2 Appellant -- so, I'll start with the Appellant. Could
3 each of the participants, on behalf of Appellant, please
4 state your name for the record.

5 MR. NISENHOLTZ: Yes. My name is Brian
6 Nisenholtz, and I'm representing Pomona Valley Hospital.

7 MR. PINCURA: My name is Stan Pincura, and I'm
8 representing Pomona Valley Hospital.

9 JUDGE BROWN: Thank you.

10 And for CDTFA, could each of the representatives
11 please identify themselves for the record.

12 MR. NOBLE: Hi. I'm Jarrett Noble representing
13 CDTFA.

14 MR. CLAREMON: This is Scott Claremon
15 representing CDTFA.

16 MR. SUAZO: Randy Suazo representing CDTFA.

17 JUDGE BROWN: And we'll state for the record, in
18 response to the Covid-19 State of Emergency the Office of
19 Tax Appeals will be conducting today's hearing
20 electronically with the agreement of all parties and
21 participants. All participants, including the ALJs, are
22 video conferencing into this hearing.

23 I'm just going to first confirm the issues, and
24 then we will admit the exhibits. And then we can talk
25 about the -- we'll confirm the schedule for today, and

1 then we will hear arguments from both parties.

2 As we confirmed during the prehearing conference
3 in this matter, and as confirmed in the prehearing
4 conference minutes and orders, there are two issues in
5 this case. The first issue is whether two purchases of
6 software from 3M should be regarded as errors for the
7 purpose of computing the percentage of use tax paid to
8 vendors in error. The second issue is whether Appellant's
9 purchase of the EsophyX System was exempt from use tax.

10 And I note that on the prehearing conference
11 minutes and orders I used the word EsophyX System. But
12 I'll clarify that it's my understanding that the only part
13 of the system at issue is the EsophyX device, and there is
14 no dispute regarding the fasteners that are also part of
15 the EsophyX System.

16 First, I will confirm with the parties that I
17 have correctly stated the issues to your understanding.

18 Appellant?

19 MR. NISENHOLTZ: Yes, those are the issues.

20 JUDGE BROWN: CDTFA, can you also confirm?

21 MR. NOBLE: We agree those are the issues, yes.

22 JUDGE BROWN: Okay. Then if no one has any
23 questions or clarifications about the issues, we can move
24 on to identify and admit the exhibits. We have
25 documentary exhibits from both parties to be considered

1 for admission into evidence. Both parties submitted their
2 exhibits at least 15 days in advance. I will note that we
3 discussed during the prehearing conference that Appellant
4 might be submitting a dictionary definition or providing a
5 dictionary definition. We had discussed whether that
6 would be marked as evidence.

7 Appellant, do you have a dictionary definition
8 that you want to submit?

9 MR. NISENHOLTZ: We decided that we did not need
10 to submit it. If we need to bring it up, since it would
11 be public record anyway of a definition, we just didn't
12 think it was necessary. So --

13 JUDGE BROWN: Okay.

14 MR. NISENHOLTZ: -- we'll pass.

15 JUDGE BROWN: Okay. That's fine. Thank you.

16 All right. Then I will just discuss the parties'
17 exhibits that have been submitted. First, I'll address
18 Appellant's Exhibits 1 through 21.

19 CDTFA, previously you indicated that there -- you
20 did not believe there'd be any -- you didn't have any
21 objections to admission of Appellant's exhibits into
22 evidence. Is that correct that you still do not have any
23 objection to admitting Appellant's Exhibits 1 through 21
24 into evidence.

25 MR. NOBLE: We have no objections.

1 JUDGE BROWN: Then I will say that Appellant's
2 Exhibits 1 through 21 are admitted into evidence.

3 (Appellant's Exhibits 1-21 were received
4 in evidence by the Administrative Law Judge.)

5 And next we will address CDTFA's exhibits. CDTFA
6 submitted Exhibits A through G into evidence -- as to be
7 submitted into evidence.

8 And, Appellant, you indicated during the
9 prehearing conference that Appellant would likely not have
10 any objection to admitting Exhibits A through G into
11 evidence. Is that correct, Appellant still has no
12 objection to admission of those exhibits?

13 MR. NISENHOLTZ: We have no objection.

14 JUDGE BROWN: Okay. Thank you. Then I will say
15 that CDTFA's Exhibits A through G are admitted into
16 evidence.

17 (Department's Exhibits A-G were received in
18 evidence by the Administrative Law Judge.)

19 Next, I'll just confirm we're not going to have
20 any witnesses testifying today, and I will go over the
21 time allocation for our schedule today. I anticipate the
22 oral hearing may take up to an hour, maybe less. And the
23 order of events will be as follows:

24 Appellant's presentation will be first, and that
25 will take up to 20 minutes. Then we may have questions by

1 the ALJs. Next, CDTFA's presentation will take up to
2 15 minutes. Again, we then may have questions by ALJs.
3 And finally, we will have Appellant's rebuttal, which
4 should take up to five minutes.

5 Does anyone have any questions about the schedule
6 or anything about the proceeding today that we should
7 address?

8 MR. NISENHOLTZ: I do have a question, Judge.

9 JUDGE BROWN: Yes.

10 MR. NISENHOLTZ: It's possible that our
11 presentation may go a few minutes over 20 minutes. We
12 gave you that time frame before we actually put everything
13 together. I'm not sure, depending on how fast we talk,
14 basically.

15 JUDGE BROWN: Okay. This is the last hearing of
16 the day. So I don't think we have a problem with giving
17 you a few extra minutes. Would you say 30 minutes would
18 be sufficient?

19 MR. NISENHOLTZ: Oh, that would be plenty. It
20 probably won't take that long.

21 JUDGE BROWN: Okay. Then we can say up to
22 30 minutes. It's only a problem when we are -- when we
23 have multiple hearings stacked up in the afternoon, and we
24 have to finish so the next hearing can go forward. Okay.

25 CDTFA, do you have anything that you want to

1 raise or any questions?

2 MR. NOBLE: No, Judge Brown. Thank you.

3 JUDGE BROWN: Okay. If no one has any questions,
4 then I believe we are ready to proceed.

5 Appellant, you may begin with your presentation.
6 You have 30 minutes.

7 MR. NISENHOLTZ: Thank you, Your Honor.

8

9

PRESENTATION

10 MR. NISENHOLTZ: My name is Brian Nisenholtz, and
11 my firm Sales Tax Resource Group was hired to find sales
12 and use tax overpayments for Pomona Valley Hospital. So
13 the area in dispute has to do with refunds of the use tax
14 that were paid directly to vendors on exempt items.

15 We filed a timely refund claim for the period
16 July 1, 2008, through June 30th, 2011, in October of 2011.
17 It took a year later, October 22nd, 2012, when we received
18 a letter from the audit determination and refund section
19 stating our claim will be verified by the West Covina
20 District Office of the Board of Equalization. I'd like to
21 note that the letter said the claim would be verified and
22 not audited. And that will be an important point later in
23 my remarks.

24 So in early 2013 an auditor from West Covina
25 contacted us to verify our claim. As the BOE, now the

1 CDTFA is apt to do, our client was selected for a sales
2 and use tax audit as well. Now, the audit period for the
3 audit was through December 31st, 2012, which means there
4 was a period, July 1, 2011, through December 31st, 2012,
5 that was not covered by any refund claim at that time.

6 So since the refund claim period and the audit
7 period did not match, we made an agreement with the
8 auditor to project the results of the claim onto the
9 period not covered by the original claim, the
10 July 1, 2011, through December 31st, 2012 period. So we
11 subsequently filed a second timely refund claim for that
12 period. So fast forward to when the auditor's review was
13 complete, the results were projected to that subsequent
14 claim period as agreed to. So we had no issue there.

15 However, there was one issue that occurred, and
16 it's the main reason we're here today. As stated earlier,
17 part of our claim was to determine how much use tax was
18 paid to vendors that was overpaid to these vendors. So
19 Section 6901 of the Revenue and Taxation Code allows for
20 the refund to be paid from the State directly to the
21 purchaser when it comes to use tax, as opposed to going
22 directly to the vendor if the refund is for sales tax.

23 So that was the case here. We examined
24 overpayments of use tax to vendors, and what we did is we
25 did a -- we took a block sample of the year 2010. So the

1 process is whatever errors or overpayments that we found
2 in 2010, that amount was divided into the total accounts
3 payable expense population of 2010 to find a percentage of
4 error. Then that percentage of error was applied to other
5 periods, accounts payable, expense population. And those
6 amounts were applied throughout our refund claim period,
7 July 1, '08 through June 30th, 2011. The results were
8 then projected to the second claim, July 1, 2011, through
9 December 31st, 2012, as agreed to with the auditor.

10 So when we were doing our 2010 test, we were at
11 June purchases, and we came upon invoices from 3M. There
12 were three invoices to be exact. These invoices appeared
13 to be for software or software maintenance contracts. So,
14 first of all, generally software is taxable if it's
15 delivered on some sort of tangible personal property, like
16 a flash drive, a disc. But it's not taxable if it's
17 transferred electronically.

18 And, similarly, software maintenance contracts
19 are taxable at 50 percent of the contract price, if there
20 are software updates that are provided in tangible form.
21 If there are no updates provided or if they are provided
22 electronically, the maintenance contract is 100 percent
23 exempt. So we couldn't tell from the invoices how the
24 software was delivered or if there's any updates with
25 respect to the maintenance contracts. So we contacted 3M

1 to answer these questions.

2 So 3M got back to us, and they let us know that
3 one of the three invoices was taxable, and the other two
4 were exempt according to the regulations. And we provided
5 an e-mail from 3M. That's Exhibit 3 that we provided. So
6 once we got these answers, we included the exempt invoices
7 in our refund claim that we later presented to the
8 auditor. And we got these answers back in September 2012.
9 So it took until February 2014 for the auditor to review
10 these invoices in our claim.

11 And she decided to verify and call 3M. And 3M
12 did let her know that the invoices were indeed exempt
13 transactions. However, they stated that they already
14 refunded the tax back to the hospital. So what happened
15 was the auditor subsequently disallowed these invoices in
16 our claim because the hospital already received the tax
17 back.

18 And we're not disputing that the hospital was
19 refunded the tax. They were refunded the tax. However,
20 we do believe that these invoices should be included in
21 the test -- in our 2010 test as an error and should be
22 projected throughout the claim period, minus the amount of
23 tax they already received. So CDTFA has continued that --

24 (Wherein there is noise interruption.)

25 JUDGE BROWN: Sorry. We're hearing background

1 noise from somebody, and I don't know who.

2 MR. NISENHOLTZ: I hear noise. I'm sorry.

3 JUDGE BROWN: No. Hold on.

4 MR. NISENHOLTZ: Should I move forward?

5 JUDGE BROWN: Sorry. This is Judge Brown. If
6 you could wait for just a moment.

7 MR. NISENHOLTZ: May I move forward, Judge? I
8 don't hear any noise anymore.

9 JUDGE BROWN: Okay. Yes. This is Judge Brown.
10 You can go ahead. Sorry for the interruption.

11 THE STENOGRAPHER: Actually, the last sentence I
12 got was, "However, we do believe that these invoices
13 should be included in the test -- in our 2010 test as an
14 error and should be projected throughout the claim period,
15 minus the amount of tax they already received."

16 So if you could take it from there, that would be
17 great.

18 MR. NISENHOLTZ: Thank you.

19 So, basically, CDTFA has contended that because
20 the amount of tax was refunded during the audit period,
21 the error was fixed during the audit period and,
22 therefore, there is no error. And our understanding, from
23 what we received, CDTFA bases this argument on the fact
24 that the audit sampling plan, which is our Exhibit 5,
25 states how sample units are treated if transactions are

1 corrected at a later date. So this was a transaction that
2 was corrected in 2012 from a 2010 tax billing.

3 So the sampling states -- I'm going to quote from
4 the exhibit. "If a sample unit is an error but the
5 transaction is corrected within the audit period, the
6 sample unit will be considered a non-error. If a sample
7 unit is an error but the transaction is corrected outside
8 of the audit period or is corrected as a result of audit
9 investigation, the sample unit will be considered an error
10 for projection of error purposes. However, an offset
11 credit should be allowed in the amount of the error."

12 So the error occurred in 2010, and the adjustment
13 occurred in September 2012. And that's why the CDTFA is
14 stating the error was corrected in the audit period
15 because the audit period was expanded to
16 December 31st, 2012. And that's why they're saying it's a
17 non-error. Let me tell you why we believe that's the
18 wrong treatment. The auditor, first of all, with respect
19 to use tax paid to vendors in error, that schedule in the
20 entire audit and refund claim, they didn't do that audit.
21 We did the audit.

22 In fact, refund claims are generally done by
23 taxpayers. Auditors don't want to spend time -- they
24 might identify a refund issue, but they will not spend
25 time auditing it. They'll spend time verifying taxpayers'

1 claims. And that's what the letter stated at the -- back
2 when I -- October 2012, Exhibit 1. The original letter
3 said, hey, the Board of -- basically, the District Office
4 in West Covina is going to verify your claim. They did
5 not say they're going to audit our claim. They're going
6 to verify our audit of our claim.

7 So I would also like to point out Audit Manual
8 Section 0401.05. This is a section in the manual
9 discussing tax auditing. Within this section is a
10 discussion on approach to auditing credits or refunds. In
11 this section it states, "Sampling and projection
12 techniques may be used by taxpayers," I'm emphasizing on
13 the taxpayers, "to determine the amount of overpayment of
14 tax liability using criteria similar to the techniques
15 used by auditors." Exactly in the manual it specifically
16 says, "Taxpayers can use the same techniques as auditors."
17 That's exactly what we did.

18 So now why is this all important? This is
19 important because our audit, using the techniques allowed
20 in Audit Manual 0401.05 was for the period July 1, 2008,
21 through June 30th, 2011. 2010 was our sample period,
22 which was agreed to by the auditor. The error corrected
23 after our audit period, September 2012, over a year later.
24 And, therefore, according to the language of the sampling
25 plan, errors that are corrected outside of the audit

1 period or corrected as a result of the audit
2 investigation, a sample unit will be considered an error
3 for projection of error purposes.

4 So please also keep in mind that 3M refunded the
5 hospital because of our contact with them. The refund
6 occurred five days after 3M answered our questions.
7 Basically, the refund occurred unbeknownst to us, our
8 firm, or the hospital representatives that has been
9 dealing with the claim. None of us knew that 3M refunded
10 the money. But as a result of our audit investigation,
11 our investigation resulted in this refund. And that is
12 the other criteria with respect to the sampling plan when
13 it states, "Errors that are corrected out of the audit
14 period or corrected as a result of an audit investigation,
15 the sample unit will be considered an error for
16 projection."

17 So we have two reasons. It's an "or". It's an
18 either/or, but we met both that this error should be
19 projected. And also, we never asked -- I want -- we never
20 asked 3M for the refund. We know pursuant to Section 6901
21 that if it's a use tax transaction, that we're supposed to
22 go directly to the State for the refund and not go to 3M.
23 And we wouldn't ask them for the refund because we knew it
24 was part of our sample.

25 So it was also agreed to project these results of

1 our claim to the second claim period, July 1, 2011, to
2 December 31st, 2012. This period was not part of the
3 audit population. Our audit population only went through
4 June 30th, 2011, with respect to our claim. So what
5 happened was, we're just projecting the results of one
6 claim through June 2011, projecting it to the last
7 18 months. Similar to a prior audit percentage error,
8 which is projected over to the next claim period.

9 So I'd like to give a hypothetical here. If
10 CDTFA never decided to do an audit, they just decided to
11 review our refund claim through June 30th, 2011, then what
12 would have happened is, the tax would have been -- the
13 refund of the tax would have been outside of the claim
14 period and outside of the audit period.

15 So, basically, what happened is this refund is
16 being denied because the CDTFA decided to expand the audit
17 period to December 31, '12, and include everything in one
18 report; both their audit and both our refund claims in one
19 report. If they separated the reports, we wouldn't be
20 here. If they decided not to do an audit through 2012, we
21 wouldn't be here. It's because they expanded the audit is
22 why we're getting this claim denied.

23 And also, I want to note that we contacted 3M
24 because we saw invoices of software that we weren't sure
25 of the taxability. We weren't sure because we didn't know

1 how it was delivered. Now, we didn't have to do that. We
2 knew an auditor was going to verify our claim. We could
3 have left it there, put it in our claim, and have the
4 auditor then review it and then request us to contact 3M
5 to find out how it was delivered.

6 If we had done it that way, if we weren't
7 proactive, well, 3M never would have refunded the money to
8 the hospital after our contact because they -- obviously,
9 it was because of our contact, because the refund was two
10 years later, and then it would have been projected. So us
11 being proactive really punished the taxpayer because we
12 found that answer out, and then we didn't know that they
13 got refunded. So it's really discouraging because now,
14 you know, our office we do other refund claims.

15 If there's any issues similar to this, because of
16 this case, we have decided to just schedule them in our
17 claim without verification. And then when an auditor
18 comes to verify, we go, okay. Yeah. We'll go find out
19 for you whether or not it's taxable or not or how it's
20 delivered because we don't want to lose out on a potential
21 valid refund for our clients.

22 So in summary on this issue, I think it's very
23 basic. We did an audit. We sampled one year to find
24 overpayments. We found the overpayment or overpayments at
25 the time we conducted our audit. And I believe, based on

1 what I've presented so far, these errors should be
2 projected.

3 So and now there's a second issue, and Stan
4 Pincura is going to cover that other contention in our
5 appeal.

6 MR. PINCURA: Hi. I'm Stan Pincura. I'm going
7 to discuss our second item of dispute in our audit of the
8 use tax paid to vendors in error for the test period year
9 2010, which is the delivery device that is contained in
10 the EsophyX System on that Pomona Valley Hospital purchase
11 from Endogastric Solutions. So, basically, the issue is
12 whether the device, which deploys the fasteners during
13 surgery, is exempt from tax, and we contend that it is.

14 So in our Exhibit 6 is the invoice from
15 Endogastric Solutions of the sale of the six EsophyX
16 Systems to Pomona Valley Hospital. The tax that is billed
17 on that invoice, the \$20,400 measure from the sale of the
18 EsophyX System is included in the measure of the tax
19 billed on the invoice. So anyway, our refund claim
20 submitted for the use tax paid to vendors was in error, we
21 included the tax paid -- the tax that Pomona Valley
22 Hospital paid to Endogastric Solutions for those six
23 systems.

24 So Exhibit 7, the EsophyX device, basically, it's
25 the Endogastric Solutions web page. And it's basically

1 saying that the device actually does deploy those
2 fasteners during surgery, mainly to treat gastroesophageal
3 reflux disease. So the fasteners themselves are
4 considered medicine per Section 6369 and Regulation 1591,
5 as they are implanted in the human body.

6 So we contend, and I'll show in here, that the
7 device is also exempt since it deploys the fasteners, it
8 is disposable, and is sold together with the fasteners.
9 So Exhibit 10 is Annotation 425.0853. It's the opinion
10 letter to the annotation. In the second paragraph, second
11 sentence, it states, "We have also held in the past that
12 disposable loading units, as well as the disposable
13 instruments and loading units, when used together, that
14 are used to join skin tissue, also qualify as sutures
15 under Regulation 1591(b)(2). Disposable staplers and
16 staples qualify as," in parenthesis, "medicines, because
17 they are sold and used as a unit. When sold or finished
18 under the condition set forth in Regulation 1591(a), their
19 sales are exempt from tax."

20 So based on the opinion and annotation, there's
21 really three requirements for the disposable instrument,
22 in this case the EsophyX device, to be exempt from tax.
23 For one is that the item must be sold or furnished under
24 the conditions set forth in Regulation 1591(a). Pomona
25 Valley Hospital Health Facility, the sales of medicines to

1 it for the treatment of human beings is exempt from tax.
2 So that requirement is met.

3 The second requirement is that the device must be
4 disposable. Per our Exhibit 8, we have a report on
5 emerging technologies which discusses the endoscopic
6 antireflux devices. The second page of that discussion,
7 that paper, that is actually on the EsophyX device. In
8 the second paragraph under Technology Under Review for the
9 description of the device, it says, "The EsophyX device is
10 a single use device." In other words, the device is for
11 one-patient procedure, and after that procedure it is
12 disposed of. It's not an instrument that's going to be
13 sterilized and reused.

14 The next, also on the fourth or fifth page of
15 that Exhibit 8, I have attached an e-mail string with Mary
16 Hermes at customer service at Endogastric Solutions. I
17 asked Mary whether the EsophyX device was disposable. In
18 her response to me on August 26 of 2020, she stated that
19 the R2000, which is the item number for the EsophyX
20 system, was a disposable device. So the second
21 requirement of the annotation is also being met that the
22 device is disposable.

23 The third requirement of Annotation 425.0853 is
24 that the disposable device is sold together with the
25 fasteners and used as a unit. So Exhibit 9 of our

1 exhibits is a web page from eSutures, which is for the
2 sale of the R2000 Endogastric Solutions EsophyX System.
3 On page 2 of that exhibit, you can see the single package
4 includes one device, one cartridge, and the 20 fasteners.
5 So the device and fastener are packaged and sold together
6 for a single price.

7 The Endogastric Solutions invoice, which was
8 Exhibit 6, also shows that the system is sold together for
9 a single price. So, again, as previously discussed the
10 device deploys the fasteners, and they are used together
11 as a unit. The third requirement of the annotation is
12 also met. Thus, we contend that the disposable device
13 included in the EsophyX System is exempt from tax as a
14 medicine under Annotation 425.0853 since it is sold
15 together with the fasteners, and they are used together as
16 a unit.

17 The Department contends that the device is not
18 preloaded with the fasteners and not disposable since it
19 can be reloaded and thus, not exempt from tax as a
20 nonreturnable container. We agree that the device is not
21 preloaded and thus, a nonreturnable container. We are not
22 arguing that it is. From the published Annotations
23 425.0853, which I've been discussing, and 425.0926, a
24 disposable device can fall under one of two exemptions; as
25 a medicine if sold together and uses a unit with the

1 fasteners, or as a nonreturnable container if preloaded
2 with the fasteners.

3 So the back up to Annotation 425.0853 was written
4 in June of 1991 and is still in the published annotations,
5 which is being relied upon by taxpayers. The Department
6 is basically saying that their annotation is incorrect.
7 Regarding whether or not the device is disposable, the
8 documents providing support that it is, including the
9 Endogastric Solutions e-mail. It is a single-use device,
10 which is disposed of after one procedure.

11 I would like to emphasis that there's no
12 requirement for the back up to Annotation 425.0853 that a
13 disposable device must be preloaded with the fasteners for
14 the device to be exempt from tax. It only requires that
15 the device be sold together with the fasteners and they
16 are used together as a unit. The disposable device in the
17 EsophyX System meets those requirements and is, thus,
18 exempt from tax.

19 JUDGE BROWN: Mr. Pincura, does that conclude
20 your presentation?

21 MR. PINCURA: Yes, that concludes my
22 presentation.

23 JUDGE BROWN: Okay. Thank you very much,
24 Appellant.

25 Now, I am going to allow time for questions, and

1 I will start with my co-panelists. Judge Wong, do you
2 have any questions for Appellant?

3 JUDGE WONG: I just have one quick question right
4 now. I'm just curious in your investigation, whether you
5 discovered any other overpayments your client made to 3M
6 outside of the 2010 sampling year, during the claim
7 period?

8 MR. NISENHOLTZ: We did not look at the entire
9 claim period. Our job was to look at just 2010. We did a
10 sample. So the hospital buys lots and lots and lots of
11 items. And so we did not go in to see if they purchased
12 other items potential -- you know, paid tax on other items
13 from 3M. That wasn't really part of the sample. We
14 weren't doing this on an actual basis. The process was
15 agreed to. In fact, the auditor also audited for
16 underpayments of use tax and used the same exact periods
17 to 2010. So we don't know.

18 We'd also like to point out since you asked that,
19 that there was a comment in some of the earlier decisions
20 in the first maybe D&R that this might not have been a
21 recurring issue. And I would disagree with that since
22 buying software and buying software maintenance contracts,
23 hospitals and many other companies, it's very common for a
24 business to buy software. The only unusual part about
25 this case is that the tax was refunded back. But it's not

1 a nonrecurring issue.

2 JUDGE WONG: But you're not aware if it actually
3 occurred outside of 2010?

4 MR. NISENHOLTZ: I am not. We did do a -- we do
5 have a refund claim from the period currently we're
6 working on, from January 2013 through March 31, 2016,
7 outside of this appeal. And that is not an issue in
8 that -- in that period.

9 JUDGE WONG: Thank you.

10 JUDGE BROWN: All right. And now I will ask
11 Judge Lambert. Do you have any questions for Appellant at
12 this time?

13 JUDGE LAMBERT: This is Judge Lambert. I don't
14 have any questions right now. Thanks.

15 JUDGE BROWN: This is Judge Brown. Let me pick
16 up with -- on the same topic about the -- whether this is
17 a recurring issue. And I just want to ask Appellant, if
18 we are trying to figure out whether this is a recurring
19 issue with -- if these errors were recurring, what should
20 we be looking at? What facts, what evidence indicate that
21 these were likely recurring errors?

22 MR. NISENHOLTZ: Well, I mean we can show how
23 much -- it's not necessarily a recurring error. It's a
24 recurring issue. It's a recurring type of transaction.
25 So for instance, software -- I mean, there's other -- I

1 believe I have to go back. You know, we haven't looked at
2 the other issues in quite some time. I'm sure there were
3 other software purchases by the hospital that were treated
4 as taxable that were not, either by being charged a tax or
5 they self-accrued the use tax.

6 We also found refunds for when they self-reported
7 tax on issues -- on items like software, and we were able
8 to get that refund back. So software is a very common
9 purchase, and the maintenance contract was the annual
10 maintenance contract. So if they -- again, if they
11 continue to use the software in the next year, there's no
12 reason why they wouldn't be purchasing that software
13 again.

14 And if they didn't purchase from 3M, they would
15 be purchasing from some other vendor a similar type of
16 software. So I don't see how buying -- this is not like a
17 unique type of item that they purchased. Software is very
18 common for most businesses to be buying.

19 JUDGE BROWN: This is Judge Brown. Thank you. I
20 guess the distinguish between recurring error and
21 recurring issue is something I want to probe just a little
22 further. I guess what I'm asking is, even if the hospital
23 continued -- going on the same vein, if the hospital
24 continued to make software purchases, is there any
25 indication one way or the other about whether this similar

1 fact pattern emerged where the hospital incorrectly paid a
2 use tax on that purchase? And if -- sorry. I'll let you
3 answer.

4 MR. NISENHOLTZ: Yes. I have to go back. It's
5 in the exhibit, the actual audit to find the actual
6 transactions. But I know we've been working with the
7 hospital, not just for this claim period but from periods
8 up through the middle of 2019. We're still filing. We
9 have two separate refund claims, and there's always
10 software. In both those claims, there are software
11 purchases where tax is being paid on the software
12 incorrectly.

13 So it's not like -- it's tough because accounts
14 payable clerks are usually the ones making decisions of
15 whether or not to pay this tax, and they may not -- you
16 know, we train them. We've gone through a couple of
17 training sessions of what's taxable and what's not
18 taxable, but there's a lot of turnover at the hospital.
19 And so these types of errors seem to pop up.

20 And so yes, we've seen other transactions where
21 they're paying tax on software where they should not. But
22 they're not in my exhibits because I didn't -- I didn't
23 include claims from future periods in -- in this appeal.

24 JUDGE BROWN: Okay. And when you say "your
25 exhibits," we're also talking about CDTFA's exhibits?

1 MR. NISENHOLTZ: Yes. Yes, because they have the
2 work papers. Correct.

3 JUDGE BROWN: Right. Okay. Then -- this is
4 Judge Brown. Let me move onto a different topic. I'm
5 sure that the parties know that the panel must consider
6 what weight to give an annotation. And so I want to ask
7 about -- with that in mind, my question is -- and I think
8 this would be to Mr. Pincura. What supports the
9 annotation that you rely on 425.0853 what supports the
10 annotation's conclusion that disposable staplers and
11 staples qualify as medicines because they are sold as a
12 unit?

13 In other words, what should we be -- when we're
14 trying to figure out how much weight to give that
15 annotation, what do we think the annotation is relying on?
16 Is there some language or authority that we can look at?

17 Mr. Pincura, I think you are muted.

18 MR. PINCURA: Yeah. Well I think, you know, the
19 opinion and annotation is spelling out, you know, the --
20 based on the Regulation 1591 one that, you know, they
21 are -- it is a medicine if it's being used together with
22 the staples and, you know, in our case the fasteners and
23 the device itself. You know, so it's -- I mean, that's
24 what the annotation is spelling out that it's -- it's --
25 not that it's a nonreturnable container but it's an actual

1 medicine because it's used together with those units.

2 So we're -- you know, based on the language and
3 the taxpayers are relying on annotations that are, you
4 know, further as they're determining taxable and
5 nontaxable sales pretty much spells out here that it's a,
6 you know, it's -- they are medicines because they're
7 combined with the State -- you know, that they're used
8 together in the procedure. I don't know if that answers
9 your question or not.

10 JUDGE BROWN: This is Judge Brown. Well, what
11 I'm trying to figure out is when the annotation makes that
12 statement, how -- is there something that we can look to
13 that we can say, oh, well, the annotation is relying on
14 this, you know, someone else's authority. Is it clear
15 from the language of Regulation 1591? For example, is
16 there some other authority like another annotation or case
17 law or whatever it might be that is consistent with that
18 finding in the backup letter?

19 MR. NISENHOLTZ: Your Honor, can I chime in?

20 JUDGE BROWN: Absolutely, yes. Go ahead.

21 MR. NISENHOLTZ: Yes. So I think -- I mean, the
22 annotation is a sentence -- one sentence. It says
23 specifically, "We have also held in the past that
24 disposable loading units as well as disposable instruments
25 and loading units when sold together that are used to join

1 skin tissue also qualify as sutures under Regulation
2 1591(b) (2)."

3 They're saying that sutures under -- so sutures
4 under Regulation 1591(b) (2) are exempt. And they're
5 saying these items are sutures. They are defined as
6 sutures and, therefore, they are exempt under that
7 regulation.

8 JUDGE BROWN: I guess my question is, do we know
9 what it is that the annotation is referring to when it
10 says, "We have also held in the past?"

11 MR. NISENHOLTZ: I'm not aware of what they've
12 held in the past. So -- but I do know that this is a
13 published annotation. It's been on the books since -- 30
14 years, and we're relying on it. I know it's -- I know
15 it's an opinion. It's the Board of Equalization's
16 opinion. And now we're not arguing that the other -- the
17 opinion that these are containers, which I think the CDTEFA
18 is going to argue. We're not arguing that they're not
19 containers, but we're arguing that they're also medicine.
20 They're considered medicine.

21 They are sold together as a unit. It's specific.
22 That is the exact reason -- the question. We don't have
23 the initial letter from the person that was addressed --
24 that this opinion letter arrived -- risen from. But it
25 says in the first paragraph of the opinion letter that,

1 "You have requested advice as to the application of sales
2 use tax to sales of skin staples and staplers when sold
3 together as a unit." So that's what they were asking.

4 That's what we would be asking if we didn't know.
5 We could have the same answer. Because they are not
6 saying we are asking about an item where we have
7 preloaded -- a preloaded stapler. They're saying it's
8 sold together as a unit. It's right there in the letter
9 that language. That was the answer. He didn't
10 differentiate in the opinion letter, well, oh, it has to
11 be preloaded. If it's just sold as unit, if it's sold in
12 the package but they're not -- the fasteners aren't in the
13 unit, then it's taxable. But if it's in the unit, it's
14 exempt.

15 It's not even addressed in the letter. So, you
16 know, I think that if -- if the State thinks -- if the
17 CDTFA thinks that that's not the case, if it has to be
18 preloaded, this annotation should not be available to the
19 public. So anyway, that's our stance.

20 JUDGE BROWN: Okay. This is Judge Brown. Thank
21 you very much.

22 If my co-panelists don't have any further
23 questions, then I will say that we can move on to hearing
24 CDTFA's presentation. Judge Wong, Judge Lambert, you're
25 ready to move on.

1 And, Mr. Noble, if you're ready, I will say that
2 CDTFA you can proceed with your presentation. And my
3 understanding is it will take up to 20 minutes.

4 MR. NOBLE: Yeah. Probably around 15 possibly.

5 JUDGE BROWN: Okay. CDTFA, you may proceed.

6

7

PRESENTATION

8 MR. NOBLE: Thank you. This is Jarrett Noble.

9 Appellant operates eight hospital facilities in
10 California, filed timely protective claims for refund for
11 the period July 1st, 2008, through December 31st, 2012.
12 To verify the claims, the Department conducted an audit
13 for the same period, which resulted in an overall credit
14 measure of \$3,598,224. Subsequently, the Department
15 conducted a reaudit based on recommendations made by the
16 Appeals Bureau, which increased the credit measure to
17 \$3,779,165. As part of the audit, the Department examined
18 transactions in which Appellant remitted use tax to the
19 Department or paid use tax to its vendors in error. The
20 Department used 2010 as a block sample and projected the
21 results to the audit period.

22 There are two remaining issues in this appeal.
23 The first is whether Appellant's tax paid purchases of the
24 EsophyX System from Endogastric Solutions qualify as an
25 exempt medicine. According to Endogastric Solution's

1 website, which is attached as part of Exhibit A, the
2 EsophyX System is an endogastric surgical instrument that
3 is used to deploy fasteners during surgery to treat
4 gastroesophageal reflux disease. The instrument is used
5 for one procedure and can be reloaded from a replaceable
6 fastener cartridge. The instrument comes packaged with
7 fasteners, however, the instrument is not preloaded.

8 The second issue is whether Appellant's purchases
9 of software from 3M should be included as errors in the
10 2010 test period. Appellant paid use tax to 3M when it
11 purchased the software, but received a refund of the tax
12 in September of 2012 from 3M. With respect to the EsophyX
13 device, Revenue and Taxation Code Section 6369, which
14 interpreted and implemented by Regulation 1591, exempts
15 from sales and use tax the gross receipts from the sale of
16 and the storage use or consumption of medicines as
17 defined, if they are dispensed or otherwise provided to
18 the patient under certain specified circumstances.

19 Section 6369, subdivision (b), excludes from the
20 definition of medicine property such as instruments,
21 apparatus, appliances, devices, or other mechanical or
22 physical equipment, or the component parts thereof. And
23 sales of such items are not exempt from tax. However,
24 Section 6369, subdivision (c), provides exceptions for
25 that exclusion, including articles that are permanently

1 implanted in the human body to assist the functioning of
2 any natural organ, artery, vein, or limb, and which remain
3 or dissolve in the body. Permanently implanted articles
4 include but are not limited to sutures. In addition,
5 Regulation 1591, subdivision, (b) (2), provides that
6 nonreturnable nonreusable needles fused or pre-threaded to
7 a suture are regarded as part of the suture.

8 There are several sales and use tax annotations
9 that discuss the application of tax to sales of kits that
10 contain exempt medicines and items that are excluded from
11 the definition of medicine. For example, Annotation
12 425.0607 in its back letter discuss the sale of an
13 endoscopic stapling system similar to the EsophyX System
14 in this appeal. The annotation notes that the system is
15 sold as a kit, and that while the fasteners would be
16 considered sutures and exempt from tax, the dispenser is
17 considered an instrument and excluded from the definition
18 of medicine.

19 Accordingly, the sale of the kit was considered
20 taxable. Annotation 425.0169 also addresses the sale of a
21 kit that includes both taxable and nontaxable items. The
22 annotation notes that when a kit is sold for a lump sum a
23 price segregation must be made between the taxable and
24 nontaxable items. This is also reflected in our own
25 administrative guidance.

1 For example, on page 13 of publication 45 for
2 hospitals and other medical facilities, notes that medical
3 kits will oftentimes contain exempt items and nonexempt
4 items, and the charges for exempt medicine should be
5 segregated from the charges for taxable items.

6 In summary, the foregoing shows that when
7 property that qualifies as a medicine is sold in a kit
8 with property that does not qualify as a medicine, only
9 the portion of the kit that qualifies as a medicine is
10 exempt from tax. We further note that there is an
11 alternative issue with respect to medicine that involves
12 containers. Regulation 1589, subdivision (b)(1)(d),
13 provides that sales of containers are not subject to tax
14 when sold with contents if the sales price of the content
15 is not required to be included in the measure of tax.

16 There are various annotations that lay this out.
17 One specific one that is particularly, like, on point is
18 425.0926, which deals with staplers that contain sutures.
19 It says that when the stapler is prefilled and is not
20 reusable, the stapler is considered a container sold with
21 content, which are medicines. And the sales of such
22 preloaded staplers are exempt from tax. Annotation 425
23 deals with -- .1150, deals with syringes, and they treat
24 syringes similarly.

25 A syringe that is not prefilled and a one-time

1 use type of syringe is considered a medical device, and
2 sales of the syringe is subject to tax. However, if the
3 syringe is preloaded and it's for a one-time use only, it
4 would be considered an exempt sale as a container
5 containing exempt contents.

6 Here, the EsophyX System is an endoscopic
7 stapling system, and the dispenser is not implanted into
8 the patient's body and, thus, does not qualify as an
9 exempt medicine, pursuant to Section 6369. Instead, this
10 portion of the system is a medical device under, which is
11 specifically excluded from the definition of medicine
12 under subdivision (b). Accordingly, under Section 6369,
13 the sale of the device is subject to tax, and the fact
14 that the device is sold with fasteners that are not
15 medicines does not change the application of tax.

16 While Annotation 425.0853 provides that when
17 disposable staplers are sold as a unit with the staples
18 the sales are exempt. The annotation in its back letter
19 do not provide further detail on the nature of the
20 staplers nor define what the term "sold as a unit" means.
21 The aforementioned authorities make it clear that
22 non-medicines do not become exempt from tax because they
23 are sold as a kit with medicines. The fact that this
24 annotation is not 100 percent explicit doesn't leave it
25 open to an interpretation that is contrary to the law.

1 There's also no evidence that the EsophyX System
2 purchased by Appellant comes preloaded or prefilled with
3 fasteners. And the fact that additional fastener
4 cartridges can be purchased, demonstrates that the device
5 can be reloaded and, thus, is reusable. Accordingly,
6 because the device is not prefilled with fasteners and is
7 reusable, this is not the type of medical device that we
8 would consider to be a container.

9 With respect to Appellant's purchases of software
10 from 3M, for overpayments and underpayments of tax and
11 sample periods, Audit Manual Section 1302.25, subdivision
12 (f), provides instructions and examples on how to handle
13 credit or debt items that may affect the taxable or exempt
14 status of an original invoice. Per the Audit Manual, any
15 sample transactions that have been subsequently debited or
16 credited due to what is relevant here, a refund should be
17 considered a non-error. The only exception would be when
18 the reversing adjustment is a result of contact with audit
19 staff during the audit process.

20 The audit sampling plan, which is part of the
21 Exhibit A, also provides that if a sample unit is an error
22 but the transaction is corrected within the audit period,
23 the sample unit will be considered a non-error. If the
24 sample unit is an error but the transaction is corrected
25 outside of the audit period and is corrected as a result

1 of the audit investigation, the sample unit will be
2 considered an error for projection of error purposes.

3 We also note that the same outcome would occur if
4 the audit were dealing with an underpayment of tax. If
5 Appellant had failed to pay tax on an invoice but did
6 remit that tax within the audit period of its own accord,
7 there would not be an error. Here, there's no dispute
8 that Appellant's purchases of the software were not
9 subject to tax and that 3M refunded the tax at issue for
10 those transactions after being contacted by Appellant's
11 representatives via credit memos dated September of 2012.

12 There's also no dispute that the audit period in
13 this appeal went through December 31st, 2012. In
14 addition, the corrections were not caused as part of an
15 audit investigation by the Department. Accordingly, the
16 transactions were corrected within the audit period and
17 pursuant to the audit manual and the audit plan used for
18 this audit are considered non-errors. While Appellant
19 asserts that the examination should be limited to the
20 period identified in its claim, the audit manual
21 specifically references the audit period. And, thus, this
22 assertion lacks merit.

23 In addition, while Appellant asserts that its
24 representatives should essentially be considered the
25 auditors, the Audit Manual clearly refers to errors

1 discovered and corrected by the Department as part of its
2 audit investigation and not a taxpayer's own examination
3 of its records via its representatives.

4 Lastly, while Appellant asserted today that all
5 the Department did was a verification with respect to the
6 overpayments, an audit in general is a verification of
7 whether a taxpayer has reported and paid their taxes
8 accurately, no more or no less. The Department's
9 verification process about -- with respect to the refund
10 period was part of this audit.

11 Therefore, the transactions are not errors for
12 the purpose of calculating the error rate and these
13 transactions were properly excluded from the Department's
14 projection during the audit. Based on the foregoing this
15 appeal should be denied.

16 Thank you.

17 JUDGE BROWN: Thank you, Mr. Noble.

18 And now I will turn to my co-panelists and ask if
19 they have any questions.

20 First, I will ask Judge Wong. Do you have any
21 questions for CDTF?

22 JUDGE WONG: Hi. Yes, I have one question. In
23 the audit working papers, auditor made a note that she
24 would take a look at whether on an actual basis whether
25 there were other transactions between the Appellant and 3M

1 whether there were any other overpayments. Do you know if
2 the auditor conducted that review?

3 MR. NOBLE: My only recollection is that the
4 Department and the auditors had noted that they found no
5 other evidence that this was a recurring issue.

6 JUDGE WONG: But -- okay. So you're not sure
7 whether the auditor actually conducted actual view of
8 transactions that took place outside of the sample period
9 of 2010?

10 MR. NOBLE: Not to my knowledge, no.

11 JUDGE WONG: Thank you.

12 JUDGE BROWN: Judge Wong, if you don't have any
13 further questions?

14 JUDGE WONG: No further questions. Thank you.

15 JUDGE BROWN: Then I will ask Judge Lambert. Do
16 you have any questions for CDTFA?

17 JUDGE LAMBERT: Hi. This is Judge Lambert.
18 Yeah, just one clarification. I think you were saying
19 that even if -- I mean, even if these were preloaded, it
20 still would be subject to tax because it's reusable,
21 because I think you were saying that it comes as a kit but
22 then also it's not disposable and you can reload it. So
23 if it's -- even if it was preloaded, would it still be
24 taxable if it's reusable?

25 MR. NOBLE: Correct. In order for something to

1 be considered a container, we would expect to see that it
2 would be preloaded as in containing the exempt contents
3 and that it's only going to be used for one time. Once an
4 instrument or device that is trying to be confined to the
5 definition of a container is used more than once, it's
6 more than a container.

7 JUDGE LAMBERT: Okay. Thanks. Just clarifying.
8 Thank you.

9 JUDGE BROWN: Okay. Judge Lambert, if you don't
10 have any further questions for CDTFA then I will proceed
11 with my questions.

12 CDTFA, if I can ask in the Appeals Bureau
13 supplemental decision and the annotation 425.0853, they
14 both make the distinction between durable and disposable
15 equipment. And I wanted to ask if you can identify where
16 does that basis exist in Regulation 1591 or Section 6369
17 or any other authority. Where do we get that from?

18 MR. NOBLE: I believe that with respect to the
19 use of those terms that the annotation is talking about
20 whether or not the stapler can be defined as a container.
21 There's no -- there's no mention of disposable items in
22 Regulation 1591 or 6369 except for catheters, which are
23 not at issue in the appeal. So I think this is more in
24 reference to 1589 and containers rather 1591.

25 JUDGE BROWN: Is there anything that you can

1 point me to that would support that -- be consistent with
2 that, like, another annotation or any other similar
3 authority?

4 MR. NOBLE: I'm sorry, is --

5 JUDGE BROWN: Or is there something --

6 MR. NOBLE: Could you repeat the question?

7 JUDGE BROWN: This Judge Brown. I'm sorry. My
8 question is just -- is there any authority that you want
9 to point me to that supports that -- the interpretation
10 that you just described that the mention of disposable
11 verses durable equipment in the annotation is actually a
12 reference to containers under Regulation 1589? Like, is
13 there some other annotation for some other authority that
14 reinforces that -- that interpretation?

15 MR. NOBLE: I would say that the annotations I
16 mentioned during the presentation, which would be --
17 excuse me, sorry -- 425.0607's back letter with respect to
18 the endoscopic stapling system gets into a discussion
19 about reusing devices and durability. Annotation
20 425.0926, which discusses medical staplers, also talks
21 about reusability and durability. And Annotation 425.1150
22 and the back letter also discusses this somewhat.

23 JUDGE BROWN: Okay. Thank you. This is
24 Judge Brown. I want to next ask CDTFA, essentially, I
25 want to pick up on the question that I asked Appellant

1 about whether there's any evidence that the errors at
2 issue regarding Issue One, the 3M -- use tax payment to 3M
3 that was refunded, is there any evidence that we should be
4 considering regarding whether those errors were likely to
5 be recurring or nonrecurring?

6 MR. NOBLE: I didn't see any indication in the
7 audit working papers that the Department looked beyond
8 2010 and the block sample that was provided by Appellant,
9 in terms of whether or not they were continuing to pay tax
10 on software that would eventually, you know, be proved to
11 be nontaxable.

12 JUDGE BROWN: This is Judge Brown. I believe
13 that then covers all of my questions. If my co-panelists
14 don't have any further questions for CDTFA, Judge Wong,
15 Judge Lambert, then we can move onto hearing Appellant's
16 rebuttal.

17 And I will say Mr. Nisenholtz and Mr. Pincura, I
18 don't know who is going to be presenting the rebuttal or
19 if you're both going to do it, but I believe we discussed
20 you would have five minutes, if that's sufficient?

21 MR. NISENHOLTZ: Yeah, that's sufficient.

22 JUDGE BROWN: Okay. Appellant, may proceed with
23 its rebuttal.

24 ///

25 ///

1 CLOSING STATEMENT

2 MR. NISENHOLTZ: Okay. I'm Brian Nisenholtz.

3 Okay. I want to bring up a couple of things that
4 were brought up in the CDTFA's arguments. First of all,
5 annotation -- going to the EsophyX System, Annotation
6 425.0853 has no reference at all to Regulation 1589. It
7 is specifically referencing 1591(a) and 1591(b) (2). So
8 that annotation, the backup, that opinion letter stated
9 that devices sold as a unit, staplers, fasteners, they are
10 sold together, there's one price sold as a unit are exempt
11 from tax.

12 So if this is not the case, the CDTFA should not
13 have this in their published annotation for taxpayers to
14 rely on. You can have one annotation that references
15 Regulation 1589 and be correct, and you can have another
16 annotation that's correct. They're not mutually
17 exclusive. So we believe that, you know, we have support
18 that shows why this device is exempt from tax.

19 Now with respect to the 3M test, the CDTFA is
20 stating that only audit staff are allowed to do an
21 investigation. Well, I brought up in my arguments it is
22 clear in 401.05 that with respect to credits and offsets,
23 that taxpayers can use the exact same techniques as
24 auditors. So I don't know why only auditors get this
25 luxury of being able to do an investigation and not

1 taxpayers.

2 We're trying -- they -- we're the one that filed
3 the refund claim. We're the one that did the examination.
4 Auditor did not do the examination. They did not sort --
5 sit through thousands -- sort through thousands of items
6 to determine whether or not use tax was paid correctly or
7 not. We put everything together in a nice package, gave
8 the auditor all the necessary invoices. She didn't look
9 at all of the invoices. She only looked at the invoices
10 in question and our schedule. We did everything. We did
11 the investigation. We contacted 3M. We're the one.

12 And the Audit Manual does not say only audit
13 staff are the ones to -- I didn't see that anywhere in
14 1302.25, that audit staff alone is the one -- is the only
15 one that can do an investigation. And 401.05 clearly
16 contradicts that. It's specific. It specifically states
17 taxpayers can use the same techniques using criteria
18 similar to the techniques used by auditors. So that's
19 what we did.

20 So, basically, if the auditor did the exact same
21 thing we did, then there would be a refund. But because
22 we did it, we don't get the refund. I think it's patently
23 unfair. And it's also patently unfair that because they
24 just -- I already think it's patently unfair that the
25 State decides to do an audit because we submitted a refund

1 claim.

2 Taxpayers are afraid to submit refund claims that
3 are valid because they are afraid the State is going to
4 audit them. And so they don't do it, but we did it. Our
5 client allowed us to file this refund claim, which we did.
6 Then they came in over a year later. In fact, they
7 examined this in 2014, this particular issue. So they
8 were slow in doing this. Because they were slow, because
9 they took over a year to even assign their refund case to
10 the district office, that's why the audit got extended.
11 If this refund was important and they were able to examine
12 it at the time we filed, we would have been done much
13 quicker. It wouldn't have -- and we -- and then the audit
14 period wouldn't have lasted through December 31st, 2012,
15 and we would have gotten our refund.

16 The only reason this is not being refunded is
17 because they wrapped up both refund claims and their audit
18 in one report. If they didn't do that, the error wouldn't
19 be inside the audit period. They're saying the error is
20 inside the audit period because they extended the audit
21 period. So that makes it a total disadvantage to our
22 client.

23 So I just wanted to dispute also that it --
24 again, I just want to reiterate. It says nowhere in the
25 Audit Manual -- I didn't see it anywhere. I can be wrong,

1 but I didn't see it anywhere because I looked at this,
2 because this was an issue that was brought up in the
3 supplemental D&R that only the audit staff can perform an
4 audit investigation.

5 An audit -- this is what I want -- we're talking
6 about the dictionary definition. An audit, according to
7 Merriam-Webster's Dictionary, is a methodical examination
8 and review. That's what we did an audit. We did a
9 methodical examination review. So we did an audit. They
10 also did an audit. I don't know why the Audit Manual only
11 applies to the auditor and not to us. Our audit was just
12 verified by the Department. And so basically, you know,
13 you've already heard the rest of our arguments. I don't
14 want to delve into anything else.

15 Stan, is there anything you wanted to add to
16 that?

17 MR. PINCURA: No. I think that covers
18 everything.

19 JUDGE BROWN: Okay. Thank you, everyone. Then
20 if I've heard all the arguments from both sides, I will
21 say -- I'll ask my co-panelists if they have any final
22 questions to either party?

23 JUDGE WONG: This is Judge Wong. No final
24 questions. Thank you.

25 JUDGE LAMBERT: This is Judge Lambert. I have no

1 more questions. Thanks.

2 JUDGE BROWN: Okay. This is Judge Brown. Then I
3 can say that this concludes the hearing. The record is
4 closed, and the case is submitted today.

5 The Judges will meet and decide the case based on
6 the evidence, arguments, and applicable law. We will mail
7 both parties our written decision no later than 100 days
8 than today. The hearing is now adjourned.

9 This also concludes OTA's oral hearing for today
10 and concludes OTA's oral hearings for the month of April.
11 Thank you everyone for participating.

12 (Proceedings adjourned at 2:13 p.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 30th day of April, 2021.

ERNALYN M. ALONZO
HEARING REPORTER