OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 18022352
	CDTFA Case ID: 976743
R. ATKINS	
dba NATURALLY ORGANIC SLEEP	

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Malcolm A. Brudigam, Attorney
Robert P. Merten III, Attorney
Carley A. Roberts, Attorney

For Respondent: Amanda Jacobs, Tax Counsel III

A. KWEE, Administrative Law Judge: On November 18, 2020, the Office of Tax Appeals (OTA) issued an Opinion sustaining a decision by respondent California Department of Tax and Fee Administration (CDTFA) on a petition for redetermination filed by R. Atkins dba Naturally Organic Sleep (appellant). CDTFA's decision denied appellant's petition of a Notice of Determination (NOD) dated August 3, 2016. The NOD is for $29,236.80 in tax, plus accrued interest, for the period January 1, 2013, through March 31, 2014. CDTFA's decision concluded that appellant failed to establish that her mattress sales qualified as exempt sales of prescription medicines within the meaning of Revenue and Taxation Code (R&TC) section 6369.

On December 18, 2020, appellant timely petitioned for a rehearing on the basis that there is insufficient evidence to support OTA's Opinion or it is contrary to law. We conclude that the grounds set forth in this petition do not constitute a basis for a new hearing.

OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (a) an irregularity in the proceedings that prevented the fair consideration of the appeal; (b) an accident or surprise that occurred, which ordinary caution could not have prevented; (c) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (d) insufficient evidence to justify the Opinion or the Opinion is

contrary to law;[1] or (e) an error in law that occurred during the proceedings. (Cal. Code Regs., tit. 18, § 30604; *Appeal of Do*, 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654.)

As provided in the State Board of Equalization (SBE)'s precedential decision in *Appeal of Wilson Development, Inc.*, *supra*, and as reflected in SBE's Rules for Tax Appeals, SBE has historically looked to Code of Civil Procedure section 657 for guidance in determining whether grounds for a rehearing exist. (See, e.g., Cal. Code Regs., tit. 18, §§ 5461(c)(5) [repealed 7/30/20], 5561(a).) OTA continues to apply the same standards as SBE for granting a rehearing; thus, it is appropriate to continue looking to Code of Civil Procedure section 657, applicable caselaw, and precedential decisions for guidance in determining whether to grant a new hearing.

Appellant alleges OTA's Opinion is contrary to law or unsupported by any substantial evidence. A ground for a rehearing on such a basis is material if it is likely to produce a different result. (See *Santillan v. Roman Catholic Bishop of Fresno* (2012) 202 Cal.App.4th 708, 728; *Hill v. San Jose Family Housing Partners, LLC* (2011) 198 Cal.App.4th 764; *Trovato v. Beckman Coulter, Inc*. (2011) 192 Cal.App.4th 319.)

In addition, to find that OTA's Opinion is against (or contrary to) law, OTA must determine that the Opinion is "unsupported by any substantial evidence." (*Appeal of Swat-Fame, Inc., et al*., 2020-OTA-045P; *Appeal of Graham and Smith*, 2018-OTA-154P, citing *Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906 (*Sanchez-Corea*).) This requires a review of the Opinion to indulge "in all legitimate and reasonable inferences" to uphold the Opinion. (*Sanchez-Corea*, *supra*, 38 Cal.3d at p. 907.) The question before us on a petition for rehearing does not involve examining the quality or nature of the reasoning behind OTA's Opinion, but whether the Opinion is valid according to the law. (*Appeal of NASSCO Holdings, Inc*. (2010-SBE-001) 2010 WL 5626976.) For example, to the extent that the evidence is undisputed or has been accepted in the light most favorable to the prevailing party, the appeal might turn on a purely legal question. A rehearing may be granted when, examining the evidence in the light most favorable to the prevailing party, with all legitimate inferences to uphold the Opinion, the Panel finds that the Opinion incorrectly stated or applied the law and, as such, it is contrary to law. (*Ibid*.; see also *Russell v. Nelson* (1969) 1 Cal.App.3d 919, 922.)

[1] Effective with petitions for rehearing filed on and after March 1, 2021, this subdivision was renumbered into two separate grounds for a rehearing. (Cal. Code Regs., tit. 18, § 30604(a)(4)-(5).) This is a non-substantive change.

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

Appellant asserts that a rehearing should be granted for three reasons. First, appellant contends that "OTA's determination in the Opinion that it lacks the ability to grant relief under the doctrine of equitable estoppel is contrary to law." Appellant also contends that OTA may disregard R&TC section 6596 because that section (which authorizes OTA to grant relief of taxes and interest when certain statutory requirements are met) is inapplicable on the basis that appellant is seeking relief of taxes and interest on equitable grounds.

It is important to note that the Opinion did not find that OTA lacks jurisdiction to exercise equitable powers under any circumstances. Article VI, section 1 of the California Constitution provides that the judicial power of this state is vested in the Courts. As far as judicial powers go, it is well settled that the state cannot be estopped from collecting taxes "because of an erroneous ruling of an administrative official as to the meaning of a tax law [citations omitted]." (*Market St. Ry. Co. v. SBE* (1955) 137 Cal.App.2d 87, 102.)

Against this backdrop, we must also keep in mind that OTA is not a court and lacks the general equitable powers of a court.[2] (Gov. Code, § 15672(b).) Thus, for example, in the past, the California Supreme Court has rejected the notion that a statewide agency of statutory origin could exercise quasi-judicial functions when dealing with vested rights. (See, e.g., *Laisne v. California State Board of Optometry* (1942) 19 Cal.2d 831, 835, 862-863 (*Laisne*); *Whitten v. California State Board of Optometry* (1937) 8 Cal.2d 444.) These cases were based on the theory that the legislature cannot, consistent with Section 1, Article VI of the state Constitution, grant judicial power to a state tribunal because those powers are vested in the judicial branch. (*Laisne*, *supra*, 19 Cal 2.d at p. 837.)

[2] We note that while SBE has been recognized as a constitutional agency for resolving tax disputes, OTA is not a constitutional agency. (Cal. Const., Art. XIII, § 17; *Citicorp North America, Inc., et al. v. Franchise Tax Board* (2000) 83 Cal.App.4th 1403, 1418).

As a limited exception to the above general legal principles, the Opinion cited the California Supreme Court's opinion in *Lentz v. McMahon* (1989) 49 Cal.3d 393, 402-403. Notably, while a state agency may, under limited circumstances, be able to exercise quasi-judicial powers such as equitable estoppel, doing so under the facts of the specific case must be consistent with the authority conferred by the legislature (here, the R&TC). That is because Article 3, Section 3.5 of the California Constitution provides that an administrative agency may not refuse to enforce a statute.

In lieu of estoppel, the legislature enacted R&TC section 6596. R&TC section 6596 sets forth the only circumstances under which a taxpayer's detrimental reliance on tax advice from CDTFA may be the basis for relief of taxes. That section specifically requires written (not oral) advice to relieve a tax liability. OTA is an administrative agency, and we have no authority under the California Constitution to decline to enforce the clear and unambiguous provisions of R&TC section 6596. Thus, equitable estoppel is not available to grant relief for oral advice because we must follow the law as set forth in R&TC section 6596. This Panel would be contravening the law by granting equitable relief of taxes based on alleged oral advice, when the statute requires written advice. As such, we find that there is no basis to grant a rehearing on this ground.

While our above findings are dispositive, it bears mentioning that the elements for equitable estoppel are not met.[3] The courts apply equitable estoppel against the government only in rare and unusual circumstances, when all of its elements are present, and its application is necessary to prevent manifest injustice. (*California Cigarette Concessions, Inc. v. City of Los Angeles* (1960) 53 Cal.2d 865; see *Appeal of Smith* (91-SBE-005) 1991 WL 280345.) The taxpayer, as the party claiming the application of estoppel, has the burden of proving that all of the elements are present. (*Appeal of Western Colorprint* (78-SBE-071) 1978 WL 3544; *Appeal of U.S. Blockboard Corporation* (67-SBE-038) 1967 WL 1380.) The four elements of equitable estoppel are: (1) the government agency must be shown to have been aware of the actual facts; (2) the government agency must be shown to have made an incorrect or inaccurate representation

[3] R&TC section 6596 relief supplants application of equitable estoppel due to alleged detrimental reliance on tax advice. Furthermore, it is well-settled law that, in the absence of a provision such as R&TC section 6596, state agencies have no power to estop the state from collecting a tax which was due and owing, even though the state's representatives may have previously provided erroneous written tax advice. (*Fishbach & Moore, Inc. v. SBE* (1981) 117 Cal.App.3d 627, 632.) However, we address the elements of equitable estoppel out of an abundance of caution.

to the relying party and intended that its incorrect or inaccurate representation would be acted upon by the relying party or have acted in such a way that the relying party had a right to believe that the representation was so intended; (3) the relying party must be shown to have been ignorant of the actual facts; and (4) the relying party must be shown to have detrimentally relied upon the representations or conduct of the government agency. (*Strong v. County of Santa Cruz* (1975) 15 Cal.3d 720; *Appeal of Western Colorprint*, *supra*; *Appeal of Campbell* (79-SBE-035) 1979 WL 4076.) Detrimental reliance is present only if the government's actions cause the taxpayer to take action which leads to increased tax liability. (*Appeal of Lopert* (82-SBE-011) 1982 WL 11689.) Where one of these elements is missing, there can be no estoppel. (*Hersch v. Citizens Savings & Loan Assn*. (1983) 146 Cal.App.3d 1002, 1010.)

Here, appellant's estoppel argument is premised upon a declaration from appellant's husband stating that during a phone conversation, an unspecified CDTFA representative "confirmed that mattresses sold under a valid prescription were exempt from sales tax."[4] Appellant has no other evidence to support its contention. There is no corroborating evidence, such as a business record from CDTFA to confirm that the call occurred and, if it did, what was discussed. We find that this declaration, dated August 7, 2019, for an alleged conversation during 2008, is insufficient to establish that CDTFA was aware of the actual facts. Thus, even if we were to accept that equitable estoppel could apply under these facts (which we do not), we find that appellant failed to establish the required elements.

Second, appellant re-asserts her contention that sales of mattresses qualify as exempt sales of prescription medicines, and contends that the Opinion, which concluded otherwise, is contrary to law. The Opinion summarized this issue as follows:

> The issue presented here is whether organic mattresses are "medicines" as defined [in R&TC section 6369]. Mattresses do not meet the general definition of medicines, which only includes a "substance or preparation intended for use by external or internal application to the human body" for the treatment of a disease. (R&TC, § 6369(b).) This definition is limited to items such as prescription drugs approved by the United States Food and Drug Administration (FDA), and other substances or preparations for application to the human body which are commonly recognized for use in the diagnosis, cure, mitigation, treatment or prevention of disease. (See Cal. Code Regs., tit. 18, § 1591(a)(9)(A)&(B).)

[4] The declaration provides no details about what facts appellant's husband provided to the CDTFA representative regarding appellant's sales of mattresses, such as whether appellant sold the mattresses in an exempt manner pursuant to R&TC section 6369(a).

> CDTFA has historically interpreted "commonly recognized" as a medicine to mean: (1) general acceptance as indicated by the greater weight of opinion in the medical community . . . (See, e.g., Business Taxes Law Guide Annotation (Annotation) 425.0053.100 (11/17/08).) We agree with this interpretation.

On this ground, appellant asserts that OTA should not have relied on a Sales and Use Tax Annotation for, in pertinent part, the proposition that a substance must be commonly recognized as a medicine by the greater weight of the medical community. Appellant also asserts that OTA erred in finding that the mattresses are not prescription medicines because the record contained evidence that the mattresses did not include "toxic flame-retardant chemicals," which appellant contends are known to the State of California to cause adverse health effects. Finally, appellant asserts OTA erred in citing the exclusion for "hospital beds" from the definition of "medicines" and contends this provision is not relevant because appellant sells mattresses, which are different from beds. (See Cal. Code Regs., tit. 18, § 1591(c)(2).)

With respect to the annotation, although annotations are not binding, OTA may exercise its independent judgment to determine the weight to afford annotations.[5] (*Appeal of Praxair, Inc*., 2019-OTA-301P; *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.) The Panel chose to accept the analysis set forth in that annotation. On the remaining assertions, appellant is merely rearguing her earlier positions on appeal. Dissatisfaction with the outcome of this appeal and attempt to reargue an issue that the Panel have already considered and decided are not grounds for a rehearing. (*Appeal of Graham and Smith*, 2018-OTA-154P.) As such, we find appellant failed to establish a basis for rehearing on this ground.

Finally, appellant contends that "OTA's determination in the Opinion that it lacked jurisdiction to provide relief [to appellant for CDTFA's] violations of its own regulation . . . is contrary to law." Citing to California Code of Regulations, title 18, (Regulation) section 1698.5 and the Opinion, appellant states "OTA determined . . . [CDTFA] violated this regulation in this case, [and] then erroneously concluded it could not provide any relief to [appellant]."

To clarify, the Opinion did not conclude that CDTFA violated its regulation. Instead, the Opinion concluded that appellant timely executed the waiver of limitations prior to expiration of

[5] Appellant questions why the Opinion cited an annotation, and correctly states that annotations are not law. We note that annotations, although not binding on OTA, may be followed by OTA and cited in an appeal by the parties. (*Appeal of Martinez Steel Corporation*, *supra*.) Annotations are exempt from complying with the requirements set forth in Chapter 3.5 of the Administrative Procedure Act, which otherwise require that agency rules and standards of general application go through the formal rulemaking process. (Gov. Code, § 11340.9(b).)

the statutory period for CDTFA to assert a deficiency against appellant. The Opinion noted that Regulation section 1698.5(b) provides that: "[a] waiver of limitation that is signed by the taxpayer prior to the statute expiration date extends the period in which a [NOD] may be issued." The Opinion found appellant's waiver valid on this basis, among others. As such, the Opinion concluded that "we need not address whether CDTFA [violated] Regulation 1698.5" because the alleged inactions taken by the auditor would not have impacted the adequacy of the NOD. For the reasons explained in the Opinion, OTA's legal conclusions remain unchanged.

In summary, we find that appellant failed to establish a ground for rehearing and appellant's petition for rehearing is denied.

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Andrew J. Kwee
Administrative Law Judge

I concur:

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Suzanne B. Brown
Administrative Law Judge

A. WONG, Administrative Law Judge, concurring:

I concur with the majority that there is sufficient evidence to support the following two conclusions from the Opinion and that they are not contrary to law: (1) the mattresses at issue do not qualify as "medicines" under the Sales and Use Tax Law, and (2) the waivers at issue were valid. Regarding the remaining issue, equitable estoppel, I reach the same conclusion as the majority, but I write separately to sketch out my rationale.

In general, a state agency may apply equitable estoppel in appropriate circumstances where the statutory scheme governing that state agency's administrative hearing process permits such relief. (*Lentz v. McMahon* (1989) 49 Cal.3d 393, 402-404.) However, a state agency's ability to apply estoppel *in tax matters* is extremely limited. "Under well-settled rules of law[,] state officers and state agencies have no power to estop the state from collecting a validly-owed tax." (*Fishbach & Moore, Inc. v. SBE* (1981) 117 Cal.App.3d 627, 632.) Specifically, "the state is not estopped from collecting a tax which was due and owing, even though the state's representatives may have previously adopted an incorrect interpretation of the law and advised the public that no taxes would become due on a particular transaction or transactions." (*Ibid*.) Revenue and Taxation Code (R&TC) section 6596, which became effective on January 1, 1985, is the exception to the general rule, basically codifying an estoppel doctrine into the Sales and Use Tax Law. (See *People ex rel. Franchise Tax Bd. v. Superior Court* (1985) 164 Cal.App.3d 526, 564 (conc. & dis. opn. of Lui, J.), disapproved on another ground in *Dana Point Safe Harbor Collective v. Superior Court* (2010) 51 Cal.4th 1, 11.)

Here, it is undisputed that the facts of this case do not satisfy the conditions set forth in R&TC section 6596, which requires *written* advice from respondent California Department of Tax and Fee Administration. And given this Panel's conclusions on the mattress and waiver issues, the tax at issue is validly owed; accordingly, estoppel is unavailable to appellant R. Atkins. On this basis, I concur with the majority that the Opinion's conclusion on the equitable estoppel issue was supported by sufficient evidence and not contrary to law.

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Andrew Wong
Administrative Law Judge

Date Issued: 4/28/2021