OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 20056171) CDTFA Case IDs 085-056; 085-055; 085-054
POMONA VALLEY COMMUNITY HOSPITAL, LTD	))))

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Brian Nisenholtz, Representative

For Respondent: Jarrett Noble, Tax Counsel III

S. BROWN, Administrative Law Judge: On July 6, 2021, the Office of Tax Appeals (OTA) issued an Opinion sustaining a decision by respondent California Department of Tax and Fee Administration (CDTFA). CDTFA's decision partially denied claims for refund filed by Pomona Valley Community Hospital, LTD (appellant) for the periods July 1, 2008, through June 30, 2011; July 1, 2011, through December 31, 2012; and July 1, 2008, through December 31, 2012 (claim period).[1]

On August 4, 2021, appellant filed a timely petition for rehearing (PFR) regarding the Opinion's holding that the purchases of software from 3M should not be regarded as errors for the purpose of computing a percentage of overpayment of use tax paid to vendors in error.[2] Appellant seeks a rehearing on the grounds that there was: an accident or surprise that occurred, which ordinary caution could not have prevented; newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the

[1] For simplicity, this Opinion on Petition for Rehearing may refer to these periods collectively as the "claim period."

[2] The PFR only disputes OTA's findings and disposition on Issue 1 of the Opinion: whether two purchases of software from 3M should be regarded as errors for the purpose of computing the percentage of use tax paid to vendors in error. The PFR is not disputing the Opinion's disposition of Issue 2 (whether the purchase of the EsophyX device for use in California was exempt from use tax).

Opinion; and insufficient evidence to justify the Opinion. We conclude that the grounds set forth in the PFR do not establish a basis for granting 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: (1) an irregularity in the proceedings that prevented the fair consideration of the appeal; (2) an accident or surprise that occurred, which ordinary caution could not have prevented; (3) newly discovered, relevant evidence, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law that occurred during the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Do*, 2018-OTA-002P; *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654.)[3] In addition to establishing that a ground for rehearing exists, the basis for rehearing must materially affect the substantial rights of the party seeking a rehearing. (Cal. Code Regs., tit. 18, § 30604.)

Newly Discovered, Relevant Evidence

A party seeking a rehearing based on newly discovered and relevant evidence must show that: (1) the evidence is newly discovered; (2) the party exercised reasonable diligence in discovering and producing it; and (3) the evidence materially affects the substantial rights of the party. (See *Doe v. United Air Lines, Inc.* (2008) 160 Cal.App.4th 1500, 1506.) In the context of newly discovered evidence, courts have concluded that new evidence is material when 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, 778-779.) Evidence is "newly discovered" if it was not known or accessible to the party seeking rehearing prior to the issuance of the Opinion. (See *Hayutin v. Weintraub* (1962) 207 Cal.App.2d 497, 512.) Newly discovered evidence is looked upon with suspicion and disfavor, and the party must make a strong showing of the necessary requirements to support a PFR on this ground. (See *Horowitz v. Noble* (1978) 79 Cal.App.3d 120, 138, citations omitted.)

A PFR will be denied when (a) the newly discovered evidence could have been produced by the exercise of reasonable diligence, (b) the party seeking rehearing has not shown due

[3] California Code of Regulations, title 18, section 30604 is essentially based upon the provisions of Code of Civil Procedure (CCP) section 657. (See *Appeal of Wilson Development, Inc.*, *supra*; *Appeal of Do, supra*.) Therefore, the language of CCP section 657 and case law pertaining to the statute are relevant guidance in interpreting this regulation. (*Appeal of Wilson Development, Inc.*, *supra*.)

diligence in discovering and producing the newly discovered evidence, or (c) no reason is shown for why the newly discovered evidence could not have been discovered and produced with reasonable diligence prior to issuance of the Opinion. (See *Mitchell v. Preston* (1950) 101 Cal.App.2d 205, 207-208.)

In the Opinion, OTA determined that the key question is whether the type of error at issue (overpayment of use tax on purchases of complete software programs) was likely to occur again in the remainder of the claim period, outside the test period. The Opinion found that appellant did not provide evidence that it made additional erroneous payments of use tax on purchases of software programs during the remainder of the claim period, and that as a result there is no basis to conclude that similar errors occurred during that period.

Appellant contends that it has newly discovered and relevant evidence that during the claim period (and outside of the test period), it purchased software and software maintenance contracts with tax paid to the vendor. Appellant argues that the evidence is newly discovered because previously it did not know that the question of recurring errors was at issue, in light of CDTFA's purported acceptance of appellant's position on that point. Appellant states that since the Opinion raised this topic, appellant will provide evidence that it purchased "software and software maintenance contracts with tax paid during the claim periods and outside the test period."

Here, appellant has failed to show that there is newly discovered and relevant evidence that warrants a rehearing. During the hearing appellant was informed that the question of recurring errors was at issue because the OTA panel questioned appellant (and CDTFA) about whether there was evidence that could establish and support that the type of error at issue was recurring during the claim period (further discussed below). In response to questioning, appellant stated that its other overpayments of tax on software purchases occurred after the claim period at issue in this appeal. In light of all circumstances, no reason is shown why any additional evidence could not have been discovered and produced with reasonable diligence prior to issuance of the Opinion.

Moreover, while appellant argues that its proposed additional evidence shows purchases of software updates during the claim period, it is not clear to what extent the additional invoices pertain to software or tangible personal property, and to what extent, if any, the software transactions would be taxable. Hence, it is unclear whether any of the additional invoices reflect

similar errors (overpayments of use tax on purchases of complete software programs) during the claim period.

Thus, the proposed new evidence does not appear to contradict the Opinion's finding of a lack of evidence of additional erroneous payments of use tax on software programs during the remainder of the claim period. Consequently, the new evidence is not likely to produce a different result, and thus does not materially affect appellant's substantial rights.

Given all of the above, we find that appellant has not established the existence of newly discovered evidence that warrants a rehearing.

Accident or Surprise

The terms "accident" and "surprise" denote some condition or situation in which a party is unexpectedly placed, to its injury, without any default or negligence of its own, which ordinary prudence could not have guarded against. (*Kauffman v. De Mutiis* (1948) 31 Cal.2d 429, 432.) A new hearing is only appropriate if the accident or surprise materially affected the substantial rights of the party seeking the rehearing. (See Code Civ. Proc., § 657; *Appeal of Wilson Development, Inc., supra*.)

Appellant contends that grounds for rehearing exist because it was surprised that page 9 of the Opinion noted a comment on Schedule 12D-2B of the audit workpapers that the two purchases at issue from 3M were non-recurring and unusual transactions, leading to the Opinion's finding that "appellant was put on notice that CDTFA considered the purchases of software from 3M to be non-recurring." In its PFR, appellant contends that this finding in the Opinion was a surprise because CDTFA did not raise or argue this point during briefing or during the appeal proceedings. Appellant states that at the time the auditor made that comment in 2014, appellant persuaded the auditor that software and software maintenance contracts are recurring types of transactions and are not unusual or non-recurring, and as a result the auditor agreed and "dropped that issue." Appellant argues that CDTFA agreed that this question had been resolved. In support, appellant notes that this issue was not argued or briefed by CDTFA during the appeal with OTA, or in the appeal proceedings before CDTFA's Appeals Bureau. Appellant contends that it had no reason to believe the issue of the 3M invoices being non-recurring transactions would be part of the appeal brought in front of OTA. Appellant argues that had it known this was relevant, it would have presented evidence of subsequent reports from CDTFA (such as CDTFA's Summary Analysis and Report of Discussion of Audit Findings) that

do not contain any mention of this topic. Appellant states it would also have presented testimony under oath that there was a discussion between the auditor and appellant's representative about CDTFA's initial position that the transactions were not recurring, CDTFA dropped that issue and thus the question had been resolved with CDTFA.

Regarding the finding that appellant alleges was a surprise, that finding was only one aspect that supports the Opinion's conclusion that appellant was on notice regarding the question of whether the errors at issue were recurring. During the hearing, the OTA panel asked both parties about whether these type of errors from the test period were recurring errors during the remainder of the claim period. In addition, CDTFA Audit Manual (Audit Manual) section 0405.20 specifies that an audit's use of a test period includes scrutinizing whether errors are non-recurring errors that should be excluded from the calculation of a percentage of error. Accordingly, given that during the appeal process appellant argued for use of a test period pursuant to Chapter 4 of the Audit Manual, the Opinion's examination of whether these errors during the test period are representative does not constitute a surprise. In addition (as discussed further below in the concurrence), the evidence shows that CDTFA already considered additional transactions and allowed appellant credit for use tax paid in error to other vendors on software maintenance and related transactions during the claim period, including based on at least one invoice that the PFR now proposes as additional evidence.[4] Hence, to the extent that CDTFA already considered the transactions shown in the additional invoices, the additional proposed evidence is not new and would not support any adjustments.

Thus, even if the Opinion had given no weight to the comment in the audit workpapers, other facts indicate that appellant must have been aware that the question of recurring errors was relevant to this appeal. Therefore, even if, hypothetically, the Opinion's reliance on the auditor's comment constituted a surprise, the omission of that finding would not change the outcome of the Opinion. Accordingly, the alleged surprise does not materially affect the substantial rights of the party seeking the rehearing, and hence does not establish a basis for a rehearing.

[4] Invoice from Zones dated May 31, 2011, for a purchase order dated May 26, 2011 for purchases totaling $13,988.70.

Insufficient Evidence

In order to find that there is insufficient evidence to justify the Opinion, OTA must determine that the Opinion is "unsupported by any substantial evidence." (*Appeals of Swat-Fame, Inc., et al.*, 2020-OTA-045P.) This requires a review of the Opinion in a manner most favorable to the prevailing party, and an indulging of all legitimate and reasonable inference to uphold the Opinion if possible. (*Sanchez-Corea v. Bank of America* (1985) 28 Cal.3d 892, 907.) The question before us on a PFR does not involve examining the quality or nature of the reasoning behind the Opinion, but whether that Opinion is valid according to the law. (*Appeal of NASSCO Holdings, Inc.* (2010-SBE-001) 2010 WL 5626976.)

Appellant disputes the Opinion's finding on page 8 that "the amounts of the purchases are only a fraction of the cost of the computer programs purchased from 3M. Accordingly, the evidence indicates these purchases of software updates, maintenance contracts, and software support are not similar to the purchases from 3M." Appellant argues that the evidence does not support this finding because each 3M invoice actually reflects a combination of various purchases (69 in total) of software and software maintenance, for an average of $2,240 per item purchased, not two large purchases. Thus, appellant contends that the amounts of individual purchases of software and maintenance are not particularly larger than a normal purchase of software. In support, appellant points to Audit Manual section 0405.20(e)'s provisions about how an audit should scrutinize items to determine whether they represent nonrecurring errors that should be eliminated from calculation of a percentage of error, suggesting that to be classified as a non-recurring error, the error "be similar, but not limited, to one or more" of three specified examples. Those examples are: (1) the size of the item is much in excess of the normal item and occurs only at rare intervals; (2) the item was omitted or included due to some unusual circumstance; and (3) the product sold is a type not ordinarily handled. Appellant argues that none of these examples apply to the two 3M invoices at issue because: (1) the purchases from 3M are of a normal price, averaging $2,240 per item, and software purchases occur throughout every year; (2) software purchases are not an unusual circumstance; and (3) appellant typically purchases software as part of its ordinary course of business.

Here, while each of the two 3M invoices lists multiple line items, the combination of items on each invoice appears to comprise a total software package purchased on the date of the invoice: one package was purchased on March 22, 2010, and the other was purchased on

April 21, 2010.[5] Thus, these purchases of complete software packages appear to be large and unusual compared to the exhibits showing appellant's purchases of software updates and revisions on varying dates for smaller dollar amounts, and it does not necessarily follow that the use tax overpayments on the two 3M purchases reflected recurring errors.

In addition, we note that CDTFA's Audit Manual summarizes CDTFA's audit policies and procedures. It is a useful resource that OTA may look to for guidance in interpreting the law; however, it is not binding legal authority. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) The Opinion explained that "we refer to the Audit Manual here because it establishes that CDTFA has a defined procedure for addressing tests conducted in audits." Audit Manual section 0405.20(e) specifically addresses only errors discovered in an audit by CDTFA. Although the Opinion considered whether this approach should be extended to apply to appellant's claim for refund, nothing in the law specifically requires such application.

In light of all of the above, there is no basis to conclude that the Opinion is unsupported by any substantial evidence, or that the Opinion is not valid according to the law. Hence, we conclude that a rehearing on the "insufficient evidence" ground is not warranted.

We find that appellant has not established the existence of any grounds for a rehearing. Consequently, the PFR is denied.

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Suzanne B. Brown
Administrative Law Judge

I concur:

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Josh Aldrich
Administrative Law Judge

[5] The April 21, 2010 invoice lists seven line items that appear to be part of the same complete software package totaling $96,597.13. The March 22, 2010 invoice lists 12 line items that appear to be part of the same complete software package totaling $57,961.07; ten items show a quantity of one item ordered, but the line for "APC Pro Usrs – E&S 24 hr" lists a quantity of five and the line for "Global Usrs – E&S Std" lists a quantity of 47.

A. KWEE, concurring:

Appellant requests a rehearing on the basis that the Opinion of the Office of Tax Appeals (OTA) erroneously concluded that two transactions involving use tax overpayments from appellant to one of its vendors (3M transactions) constituted non-recurring transactions. The two 3M transactions occurred during a test period of calendar year 2010 (the 2010 test period) examined by respondent California Department of Tax and Fee Administration (CDTFA). Based on OTA's conclusion that the type of overpayments that occurred with the 3M transactions are non-recurring, the Opinion concluded it was not appropriate to project the 3M transactions to the remainder of the claim period (July 1, 2008, through December 31, 2012) and denied appellant's refund claim. It is undisputed that 3M refunded appellant the overpaid use tax for both transactions during the 2010 test period, in the form of a credit memo dated September 24, 2012. As such, the issue here is whether appellant is entitled to an additional refund measured by $890,730 (as determined by appellant), based on projecting the two use tax overpayments to 3M during 2010, to the remainder of the claim period. Appellant's theory for allowing a credit is the assumption that appellant made similar use tax overpayments to 3M or other vendors that would have recurred throughout the claim period (i.e., it is a "recurring" error). Appellant asks to receive a refund from CDTFA for those additional presumed use tax overpayments to 3M or other vendors throughout the remainder of the claim period. If a transaction is non-recurring, then it would not be projected because, by definition, a "non-recurring" transaction does not reoccur throughout the audit period. On the other hand, if a transaction is not an error, then it would similarly not be projected on the theory that the transaction was handled correctly. In its petition for rehearing, appellant identified several grounds for a rehearing in connection with OTA's conclusion that the 3M transactions are non-recurring errors.

CDTFA's decision disallowed appellant's refund claim on the basis that the two transactions involving 3M do not constitute errors and, as such, CDTFA declined to project the 3M transactions to the remainder of the claim period. On appeal to OTA, the primary dispute concerned whether the 3M transactions constitute errors.[1] Nevertheless, a comment in CDTFA's audit working papers indicated that the 3M transactions are non-recurring. CDTFA did not raise

[1] OTA's Opinion identified this issue as "Whether two purchases of software from 3M should be regarded as errors for the purpose of computing the percentage of use tax paid to vendors in error."

this contention on appeal before OTA. In its petition, appellant contends surprise, because from appellant's understanding, CDTFA previously conceded that the transactions were recurring (if not errors). In response to the petition, CDTFA reasserts its position that the 3M transactions are properly excluded on the basis that they are non-errors and cites to its public guidance for the criteria to determine whether transactions are considered as errors or non-errors. CDTFA did not, however, offer a position on whether the 3M transactions are recurring or non-recurring.

Appellant raises three grounds for a rehearing. Appellant contends that: (1) denying the claim on the basis that the 3M transactions are non-recurring constitutes an accident or surprise; (2) there is insufficient evidence to conclude that the transactions are non-recurring; and (3) appellant has new and relevant evidence to support that the transactions are recurring. The underlying source of contention for all three grounds pertains to OTA's determination that the 3M transactions are non-recurring.

While I concur with the holding of the majority to deny the petition for a rehearing, I express no opinion on whether the 3M transactions are recurring or non-recurring. Furthermore, I would emphasize that no implication that these types of transactions are "errors" for purposes of a statistical sample should be taken from the majority's Opinion, and I would disagree with any such implication. In order to grant a rehearing, it is not sufficient merely to establish that a ground for a rehearing exists. (Cal. Code. Regs., tit. 18, § 30604(a).) In addition, the party requesting a rehearing must establish that the ground materially affects the substantial rights of the party seeking a rehearing. (Cal. Code. Regs., tit. 18, § 30604(a).) OTA's regulations do not define or clarify what is meant by "materially." In cases of ambiguity, and as provided in *Appeal of Wilson Development, Inc.* (94-SBE-007) 1994 WL 580654, it is appropriate for OTA to look to Code of Civil Procedure section 657 and applicable caselaw as relevant guidance in determining whether a ground has been met to grant a new hearing. In cases where it is asserted there is insufficient evidence to support the decision, the courts have concluded materiality, for purposes of granting a rehearing, exists if the ground for a rehearing 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.) As such, for purposes of California Code of Regulations, title 18, (Regulation) section 30604, a way to

establish a ground for a rehearing is material is by showing it is more likely than not to produce a different result.[2]

Even if we were to assume, arguendo, that a ground for rehearing exists, it is clear from the record that the 3M transactions do not constitute errors. Here, appellant filed claims for refund on October 26, 2011, February 1, 2013, and November 4, 2015. Appellant's claims for refund cover the period July 1, 2008, through December 31, 2012. Appellant's vendor, 3M, refunded the use tax to appellant on September 24, 2012, which is within the period for which a refund is sought. Appellant did not file any of the above claims for refund in *response* to a CDTFA audit. The only reason CDTFA investigated appellant was to verify *appellant's own* claimed refund. Thus, the 3M transactions cannot be considered "errors" picked up during a CDTFA audit. To the contrary, appellant claimed and received a full refund for overpaid tax from 3M during the claim period identified in appellant's refund claims.

The finding, and the reasoning for finding, that this is a non-error is also consistent with the audit sampling plan that CDTFA provided to appellant,[3] which cites CDTFA Audit Manual section 1302.25 (August 2011), discussing statistical sampling, and explained that "If a sample unit is an error, but the transaction is corrected within the audit period, the sample unit will be considered a non-error."[4] The reasoning is that since appellant discovered, identified, and self-corrected the 3M overpayments (by seeking and obtaining a refund from 3M), these transactions could never have been picked up by CDTFA in a subsequent audit because they were timely self-corrected by appellant.

In support of its petition for rehearing, appellant also asserts that it made additional recurring use tax payments in error to other vendors outside the 2010 test period (e.g., in 2008, 2009, 2011, and 2012). Appellant's argument and submission raises nothing new because the record demonstrates that CDTFA already examined and did in fact allow appellant credit for use

[2] In reaching this conclusion, we offer no opinion on whether there may be additional standards to establish materiality. We only find that one way to establish materiality, for purposes of OTA's Rules for Tax Appeals, is by meeting the different result test set forth above.

[3] CDTFA discussed this plan with appellant on September 12, 2013, and noted that appellant refused to acknowledge receipt of the plan. CDTFA's Assignment Activity History explains that during the meeting to discuss the audit plan appellant's representative, Mr. Nisenholtz, did not wish to sign the audit sampling plan.

[4] CDTFA's Audit Manual is not legal authority; however, it contains recognized and accepted accounting procedures which OTA may look to for guidance, especially in cases where, as here, it explains reasonable accounting procedures which are not otherwise set forth in applicable statutes or regulations. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P; *Appeal of Amaya*, 2021-OTA-328P.)

tax paid in error to other vendors on software maintenance and related transactions during the claim period. CDTFA examined these transactions based on invoices submitted by appellant, on an actual basis, throughout the claim period (CDTFA Schedule 12I). Approximately 42 additional transactions were identified and examined (CDTFA Schedule 1R_12I-2a). As one example, appellant submitted Invoice S23119300301, issued by Zones, dated May 31, 2011, for $13,988.70 in support of additional recurring errors within the claim period. However, review of CDTFA Exhibit E, Schedule 1R_12I-2a, line 18, demonstrates that appellant already submitted this invoice to CDTFA for consideration during the audit of its refund claim. Furthermore, CDTFA allowed a refund in the amount of $6,994, and disallowed the balance, on the basis that tax applies to 50 percent of a lump sum charge for optional maintenance contracts pursuant to Regulation section 1502(f)(1)(C). It is unclear from the face of appellant's additional submission (which consists of purchase invoices from various vendors) to what extent the underlying invoices pertain to software or tangible personal property, and to what extent, if any, the software transactions would be taxable. Nevertheless, it appears that these transactions were already examined and allowed, and to the extent nontaxable, a credit was allowed. Nothing contained in the invoices is new or changes the measure of tax or refund allowable. As such, the invoices are only potentially relevant in connection with determining whether, assuming the 3M transactions are errors, those errors recurred throughout the claim period (in which case the 3M transactions could be projected).[5] Here, since the 3M transactions are not errors, recurrence is a non-issue, and we need not further address the additional invoices.

Based on the foregoing, I concur in denying the petition.

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Andrew J. Kwee
Administrative Law Judge

Date Issued: 2/10/2022

[5] It also bears mentioning that the two 3M invoices are high dollar transactions: an invoice dated March 22, 2010, for $63,612.28 (including tax), and an invoice dated April 21, 2010, for $106,015.35 (including tax). As a general matter, we would tend to expect outliers, such as extremely high value items compared to the remainder of the population, to be stratified out and examined on an actual basis (i.e., no projection), because high-dollar transactions tend to be under-sampled if included in a statistical sample size with low-dollar items. We need not examine this line of reasoning, however, based on our conclusion that the 3M transactions are not errors.