

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF)
)
OLYMPUS AMERICA, INC.,) OTA NO. 19125560
)
 APPELLANT.)
)

CERTIFIED COPY

TRANSCRIPT OF PROCEEDINGS

SACRAMENTO, CALIFORNIA

TUESDAY, SEPTEMBER 20, 2022

Reported by:

SARAH M. TUMAN, RPR
CSR No. 14463

Job No. :
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15 TRANSCRIPT OF PROCEEDINGS, taken at
16 400 R Street, Sacramento, California,
17 commencing at 9:43 a.m. and concluding
18 at 11:28 a.m. on Tuesday, September 20, 2022,
19 reported by Sarah M. Tuman, RPR, CSR No. 14463,
20 a Certified Shorthand Reporter in and for
21 the State of California.

1 APPEARANCES:

2
3 Panel Lead: ALJ JOSH LAMBERT

4
5 Panel Members: ALJ MICHAEL GEARY
6 ALJ SHERIENE RIDENOUR

7
8 For the Appellant: AMY SILVERSTEIN, ESQ.
9 R. TOBIN

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

12 KEVIN SMITH
13 SCOTT CLAREMON
14 JASON PARKER
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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-12 were received at page 6)

(Department's Exhibits A-E were received at page 6)

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APPELLANT'S WITNESS:	DIRECT	CROSS	REDIRECT	RECROSS
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1 Sacramento, California; Tuesday, September 20, 2022

2 9:43 a.m.

3 -- oOo --

4 JUDGE LAMBERT: We are now on the record in the
5 Office of Tax Appeal's oral hearing for the Appeal of
6 Olympus America, Inc., Case Number 19125560.

7 The date is September 20, 2022, and the time is
8 9:44 a.m. My name is Josh Lambert, and I'm the lead
9 administrative law judge for the purposes of conducting
10 this hearing. And my co-panelists today are Judge
11 Sheriene Ridenour and Judge Michael Geary.

12 CDTFA, could you please introduce yourselves for
13 the record?

14 MR. SMITH: My name is Kevin Smith from the CDTFA
15 Legal Department.

16 MR. CLAREMON: Scott Claremon.

17 MR. PARKER: And Jason Parker.

18 JUDGE LAMBERT: Thank you for attending.

19 And representatives -- representatives for
20 Appellant, could you please introduce yourselves as well?

21 MS. SILVERSTEIN: My name is Amy Silverstein, and
22 I'm representing Olympus today.

23 MR. TOBIN: And I'm Bob Tobin from Olympus.

24 JUDGE LAMBERT: Thank you.

25 And also, Mr. Tobin, when you -- you speak, if

1 you could maybe get a little closer.

2 MR. TOBIN: Speak louder?

3 JUDGE LAMBERT: Just so it picks up on the
4 YouTube livestream.

5 As agreed to at the prehearing conference, the
6 issues are whether parts used to repair a non-California
7 customer's equipment pursuant to an optional maintenance
8 contract at a repair facility in California are exempt
9 from use tax under R&TC Section 6009.1; whether Appellant
10 is entitled to relief from tax penalties and interests
11 pursuant to R&TC Section 6596; and whether Appellant is
12 liable for the negligence penalty.

13 FTB [sic] provides Exhibits A through E;
14 Appellant provides Exhibits 1 through 12. There are no
15 objections to the evidence, and it is now in the record.

16 (Appellant's Exhibit Nos. 1-12 were received in
17 evidence by the Administrative Law Judge.)

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

20 JUDGE LAMBERT: And just as we discussed before,
21 CDTFA submitted a statement of undisputed facts.

22 And, Ms. Silverstein, could you just confirm on
23 the record that you don't dispute those facts?

24 MS. SILVERSTEIN: We do not dispute those facts.

25 JUDGE LAMBERT: Okay. Thank you.

1 And, Mr. Tobin, you'll be testifying; is that
2 correct? As a witness?

3 MR. TOBIN: Yes.

4 JUDGE LAMBERT: So before Ms. Silverstein's
5 presentation, I can swear in Mr. Tobin, and you can have
6 45 minutes to explain your position.

7 So I could swear you in right now, if you could
8 please raise your right hand?

9
10 ROBERT TOBIN,
11 called as a witness on behalf of the Appellant, having
12 first been duly sworn by the Administrative Law Judge, was
13 examined and testified as follows:

14
15 MR. TOBIN: Yes.

16 JUDGE LAMBERT: Okay. Thanks.

17 And, Ms. Silverstein, if you're ready to proceed,
18 you can have 45 minutes for your presentation with his
19 testimony. And you can proceed now. Thank you.

20 MS. SILVERSTEIN: Okay. Great. Thank you very
21 much.

22
23 PRESENTATION

24 MS. SILVERSTEIN: And thank you all for your time
25 today.

1 As you know, I'm Amy Silverstein. I'm
2 representing Olympus today. This case involves repair
3 parts used at an Olympus repair facility in San Jose,
4 California.

5 In three prior audits the State Board taxed parts
6 used to repair the equipment of California customers but
7 did not -- did not and never did tax the parts used to
8 repair equipment of out-of-state customers.

9 And we agree that tax was -- is proper on the
10 repair parts for the in-state customers. Although there
11 was no change in facts at all, the Board abruptly changed
12 its position and assessed use tax on the repair parts for
13 the out-of-state customers' equipment.

14 What is even more surprising is that there is a
15 statute directly on point, which excludes these repair
16 parts for out-of-state from use tax. The facts are very
17 simple:

18 The customer ships its equipment from
19 out-of-state to the repair facility in California.
20 Olympus removes the broken part, replaces it with a new
21 part that's exactly the same, and then sends the equipment
22 back to the customer out-of-state for use in the
23 customer's medical practice out-of-state.

24 The customer isn't charged for the repair because
25 it had purchased an optional maintenance contract when it

1 purchased equipment.

2 Now, CDTFA argues that these repair parts for the
3 out-of-state customers' equipment is subject to use tax.

4 This is incorrect because Revenue and Tax Code
5 Section 6009.1 says there's no use, and so there's no tax.
6 We reproduced the statute on the poster over here.

7 It says that use "does not include exercising any
8 right over tangible personal property for the purpose of
9 being attached to or incorporated into other tangible
10 personal property to be transported outside the state and
11 thereafter used solely outside of the state."

12 This is exactly what Olympus does when it repairs
13 an out-of-state customer's equipment. It exercises a
14 right over the repair parts for the purpose of
15 incorporating them into the customer's equipment to be
16 transported outside of the state and thereafter used
17 solely outside of the state.

18 Given the exclusion statute directly on point, we
19 believe this is a very simple case. And we've struggled
20 to understand why it's still going on.

21 Now, CDTFA cites authorities and makes argument
22 regarding why the repair parts are taxable. But that's
23 not what this case is about.

24 Items can be taxable in the first instance. But
25 if an exemption or exclusion applies, then no tax is due.

1 And CDTFA has not and cannot explain why the exclusion
2 statute does not apply.

3 Specifically, CDTFA relies on the regulation, but
4 of course, a statute always wins out over a regulation.

5 The regulation addresses optional maintenance
6 contracts. And it says that, if repair work is performed
7 under a maintenance -- optional maintenance contract, the
8 repairer is regarded as the consumer of the parts that are
9 furnished.

10 It does not say that the parts are taxable; it
11 says the repairer is regarded as the consumer of the
12 parts.

13 So under that regulation, if there was tax due,
14 the tax would be a use tax because the repairer in this
15 case, Olympus, is regarded as the consumer of the parts.

16 And this is why the parts for the equipment
17 repaired for in-state customers is taxable. There's no
18 exclusion; so use tax applies.

19 But for an out-of-state customer, 6009.1 states
20 expressly that the repair is not a use. And the statute
21 necessarily prevails over the statute [sic]. So use tax
22 does not apply to the repair parts used for the
23 out-of-state customer's equipment.

24 Okay. I'm going to ask Mr. Tobin to testify now,
25 unless your Honors have any questions.

1 JUDGE LAMBERT: He can testify now. We -- we'll
2 save our questions until after you finish your
3 presentation. Thanks.

4 MS. SILVERSTEIN: Okay. Thank you.
5

6 DIRECT EXAMINATION

7 BY MS. SILVERSTEIN:

8 Q Okay. Mr. Tobin, I was going to ask you to state
9 your name, but we can skip that.

10 A Bob Tobin.

11 Q What is your educational background?

12 A I have a bachelor's in business administration
13 from Hofstra University with a concentration in public
14 accounting.

15 Q Do you work for the Taxpayer?

16 A I do.

17 Q How long have you worked there?

18 A 25 years.

19 Q What is your current position?

20 A Vice president of tax, corporate insurance, and
21 transfer pricing.

22 Q Do your duties include California sales and use
23 tax compliance?

24 A They do.

25 Q As a result of those duties, are you familiar

1 with Olympus's medical equipment and repair business and
2 qualified to testify about it today?

3 A I am.

4 Q What medical equipment does Olympus sell?

5 A Primarily -- well, Olympus, worldwide, has, like,
6 70 percent of the -- the market for endoscopes -- like,
7 colonoscopes used in colonoscopies -- which is -- that --
8 that's what's the diagram you see --

9 (Reporter admonition)

10 THE WITNESS: Oh, yeah. So the -- the medical --
11 so it's -- primarily, it's medical equipment. That's
12 what's being repaired in San Jose.

13 The endoscope -- there's a variety of
14 endoscopes that -- that are made for -- they're tailored
15 to different medical procedures.

16 The colonoscopies -- which I believe that's the
17 scope on the -- the screen right now is a colonoscope --
18 that the tube you see hanging down that -- that's a
19 flexible tube that can be steered through the body with
20 the controls on the -- on the top control here.

21 But there's also -- we call that -- that's a
22 tower of equipment that has different -- so that -- so
23 that the tube that's inserted into the body has a number
24 of smaller tubes inside it that pass through to -- like,
25 it finds a polyp, it can snare it, you -- you put a snare

1 in there, and you can snare, and you can pull it out so
2 you can -- that's the benefit of the procedure is you can
3 fix the problem at the same time that you're diagnosing
4 the problem.

5 So there's a number of pieces of equipment that
6 are used with it. There's a light source because you --
7 you're shining light through one of the tubes.

8 There's an air channel for -- because you
9 blow up -- because they pump air into the intestines. So
10 it kind of expands it to make it easier to, you know -- to
11 see polyps. Because it's all a visual thing.

12 So those -- those -- as you can see, there's a
13 handful of pieces of equipment -- you know, light source,
14 air, water -- so any of those pieces would be -- or all
15 those pieces are -- are designed and manufactured by
16 Olympus Japan.

17 So when we repair it, we're just buying
18 replacement parts from Japan and inserting them into
19 the -- during the process.

20 BY MS. SILVERSTEIN:

21 Q So is this image on the screen right now
22 representative of all the equipment that Olympus repairs
23 at the San Jose facility?

24 A Yes.

25 Q Okay. And do you want to scroll to the next

1 slide.

2 Can you explain what this is?

3 A So -- right. So there's a number of parts. You
4 can see there's a number of parts.

5 A lot of these, like, the -- the diagrams that
6 we're going to follow after that schedule are pretty much
7 a diagram of this top-right control unit.

8 So what we did is we just -- on -- on these
9 slides -- we identified some key parts that are part of
10 the endoscope.

11 We put part numbers on there so you can see that
12 they actually tie back to what's being taxed in the audit.
13 And so we gave two different types of scopes. I think
14 they're both colonoscopes.

15 So yeah. So -- so what -- typically what'd
16 happen is we would replace -- so one of the -- so we have
17 a video of -- of repairs. And if you look at the -- you
18 see that tube on the bottom right, that's the tube that's
19 inserted in the body.

20 One of the repairs that we're going to show you
21 is whenever there's, you know, a hole -- a breach in that
22 plastic, then they have to cut it off and they have to
23 replace it. It's called a "bending cover."

24 So that's -- they say that that's the most common
25 repair is replacing the bending cover.

1 So typically, you know, a customer will see that
2 there's a problem with the scope during the procedure, and
3 so they'll call the service center to, you know, lodge a
4 complaint. Because I think they need approval to just
5 send it to San Jose for repair.

6 So once they get the approval, they send it in.
7 And during that process, we determine what the problem is
8 and determine what the cost is.

9 If it's part of a -- an optional maintenance
10 contract, it's not something we're going to charge the
11 customer. We just, you know, keep track of the cost, you
12 know, for our records.

13 Q So just to --

14 A Did I go off point there for a moment rambling?

15 MS. SILVERSTEIN: Well, it's okay.

16 Just -- just to be clear -- so this is Exhibit 2,
17 your Honors. And the reason we're showing this to you is
18 just so you can get an image in your mind of the type of
19 products that are repaired at the facility and also, you
20 know, the various parts that CDTFA, you know, ended up
21 imposing use tax on.

22 And we are going to show you a video of the
23 actual repair process. But this is just to kind of give
24 you the context.

25 THE WITNESS: So it does -- so as you page

1 through, this -- this is just showing the -- the shaft and
2 then the number of tubes that are in, you know, kind of --
3 that is comprised in this -- the product.

4 BY MS. SILVERSTEIN:

5 Q So does Olympus sell optional maintenance
6 contracts for repairs of customer equipment?

7 A We do.

8 Q And where does Olympus get the repair parts it
9 uses to perform the optional maintenance contracts?

10 A From Olympus Japan.

11 Q And are the repair parts the same parts that are
12 used to manufacture the products initially?

13 A They are.

14 Q Where does Olympus take title to the repair
15 parts?

16 A When they're shipped from Japan.

17 Q So is it correct, then, that no tax -- sales tax
18 was paid when Olympus purchased the parts from Japan?

19 A Correct.

20 Q Okay. And can you tell us a little bit about the
21 repair facility -- the repair facility in San Jose -- when
22 it was established, its size, and so forth?

23 A It was established in 1979. So Ringwood Avenue,
24 but it was recently moved.

25 There's about 666 people working there. And the

1 payroll is about \$43 million. But annual payroll it's
2 about \$43 million. So it's a sizable --

3 JUDGE LAMBERT: Mr. -- Mr. Tobin, please make
4 sure you speak a little -- maybe a little louder or closer
5 to the microphone so we can hear you. Thanks.

6 THE WITNESS: Oh. And slower?

7 JUDGE LAMBERT: I think, when you turn your head,
8 it doesn't -- the microphone doesn't pick it up as much.

9 THE WITNESS: Okay.

10 JUDGE LAMBERT: So I think you kind of have to
11 speak into the microphone even though you may be talking
12 to Ms. Silverstein.

13 THE WITNESS: So the facility is located in San
14 Jose. It has about 666 employees as of now, today.
15 \$43 million in payroll -- annual payroll. We've been
16 there since 1979. We recently moved a -- a couple of
17 miles away but still within San Jose.

18 BY MS. SILVERSTEIN:

19 Q At this facility, does Olympus repair equipment
20 of both California customers and out-of-state customers?

21 A Yes.

22 Q Approximately what percent of the repairs are for
23 California versus non-California customers?

24 A It's -- roughly 8 percent of the business is
25 California.

1 Q Okay. And I think you already really described
2 what happens when a customer with an optional maintenance
3 contract needs their equipment repaired.

4 Want to go over that quickly, again?

5 A I -- I just want to make sure. Was there -- I
6 said it was 8 -- 8 percent. Was there -- did you --

7 JUDGE GEARY: Did you say 8 percent?

8 THE WITNESS: 8.

9 JUDGE GEARY: Okay. Thank you.

10 MS. SILVERSTEIN: 8 percent California.

11 THE WITNESS: 8 percent California. Sorry.

12 BY MS. SILVERSTEIN:

13 Q Just, at a high level, describe what happens when
14 an -- a customer with an optional maintenance contract
15 needs their equipment repaired.

16 A All right. So they've got -- they identify that
17 there's a problem. So it's usually -- it could be a video
18 problem. The -- the -- so there's some problem with the
19 scope, and they want to return it. So we -- so they -- I
20 think they need authorization.

21 So they have to call our customer service line
22 who will give them, like, an approval number. We ship it
23 in. Then it goes into a process where they're -- try to
24 figure out what is the problem with the scope.

25 And then, once they determine what that is, they,

1 you know, disassemble the scope to remove the defective
2 part. And then they replace it with a new part. It's --
3 that we purchased from Japan.

4 Then they'll do testing. And then, once it's --
5 to see if there's anything else wrong as well. And if --
6 once it's ready to go, then they just package it back up
7 and ship it back to the customer.

8 And I think their target is to get it back within
9 48 hours. So -- well, once we receive it. So that's
10 another indication it's a pretty transitory presence. It
11 just comes here. We fix it. It goes back.

12 Because that -- that -- the colonoscopy business
13 is -- is, in a sense, it kind -- it almost -- look at --
14 some of the major places will look like a, you know -- a
15 factory that they just move from, you know -- from bed to
16 bed.

17 You do have to obviously have to sterilize it in
18 between procedures.

19 But if they're -- if they don't have that -- one
20 of the scopes, that kind of delays -- that sets them back.
21 So that's why we try to get back to them as soon as
22 possible.

23 Q If an out-of-state customer sends its equipment
24 to San Jose for a repair, will it always be shipped back
25 to the customer out-of-state after the repair?

1 A Yes.

2 Q And how do you know that?

3 A It's -- well, because the -- when -- when -- if
4 you say, like, the Cleveland Clinic will send in a
5 defective scope -- so it was being used in, you know,
6 Cleveland, Ohio. They ship it to us. We fix it. Two
7 days later we ship it back. It's going back to Cleveland
8 Clinic in Ohio -- so, you know, they're -- they're using
9 it in their business.

10 Q Does Olympus charge these customers for the
11 repair pursuant to their optional maintenance contract?

12 A No, not for the repair.

13 MS. SILVERSTEIN: Okay. And we're going to show
14 the video now. We have two, actually -- two different
15 pieces that are being repaired.

16 They're short.

17 (Video played)

18 BY MS. SILVERSTEIN:

19 Q So basically, what you're seeing there is the
20 replacement of that cover on the long piece and then also
21 that kind of rounded plastic piece. They take it out;
22 they put a new one in.

23 Do you have any other comments about that?

24 A No.

25 Q Okay. Do you want to share the next video?

1 A That's what --

2 Q Oh.

3 A -- I'm getting concerned about -- going to the
4 next video.

5 Q Oh.

6 (Video played)

7 BY MS. SILVERSTEIN:

8 Q Are you familiar with Olympus's sales and use tax
9 treatment of the repair parts at the repair facility in
10 San Jose?

11 A Yes.

12 Q Has Olympus paid tax on the repair parts for
13 repairing equipment of customers outside of California?

14 A No.

15 Q And why is that?

16 A Because 6009.1 excludes it.

17 Q Okay.

18 A The tax and use.

19 Q And has Olympus paid use tax on the repair for
20 repairing equipment of California customers?

21 A Yes.

22 Q And why is that?

23 A Exclusion doesn't apply to something that stays
24 within the state.

25 Q Okay. And does Olympus use any consumables, such

1 as solvents, in their repair process?

2 A Yes.

3 Q Does Olympus pay sales and use tax on those
4 consumables used in the repair process?

5 A Yes.

6 Q Okay. And why is that?

7 A Because they're actually consumed. There's no --
8 there's no exclusion for -- for those consumables.

9 Q Okay. Thank you.

10 So I understand that you've done a lot of work to
11 find and understand the legislative history of Rev. and
12 Tax Code 6009.1.

13 Can you please describe how you got the "leg.
14 history" and what you learned about the purpose of the
15 statute?

16 A Yeah. When -- when the issue first was raised,
17 it didn't take long before they figured out 6009.1 should
18 exclude it. And so -- but the auditor didn't agree.

19 So I was -- I wanted to do more research on it.
20 So I, at the suggestion of an adviser who said, "Well, why
21 don't you contact -- why don't you get the legislative
22 history?"

23 So I called this -- this company, Legislative
24 Intent, LLC, who's -- that's what they do is they go and
25 they'll -- they'll do the research.

1 So that's when I learned that the, you know --
2 the legislation for 6009.1 happened in 1943. And
3 fortunately, there's a few memos and letters going back
4 and forth between Board of Equalization and the Governor's
5 Office and also an attorney there at the time.

6 They were kind of explaining that -- that it
7 was -- apparently this company called the Pullman Company,
8 which is a train -- it's -- they had a business where they
9 would run sleeper cars that were attached to rail -- to --
10 to trains that would go across country.

11 And so, you know, they -- because of the number
12 of railroads throughout the country, they would ship
13 their, you know, defective sleeper car to California --
14 there was a repair shop in Richmond -- and they would do
15 the same, where they would replace parts and ship it back
16 out-of-state.

17 And so, apparently, Pullman must have complained
18 and raised -- you know, raised the issue. And so there
19 was a -- a move or a push to exclude from tax any parts
20 that were installed in California -- if it was only going
21 to be a transitory presence in California and shipped
22 out-of-state, they were going to exclude it.

23 And the -- and the sole reason is because
24 they wanted -- they thought that having this tax would --
25 would discourage companies from setting up repair

1 operations in California.

2 That's the whole reason for the exclusion. It's
3 nothing about the part itself. It's -- it's the fact that
4 what's the situation you're using it in? Well, it's --
5 it's a transitory presence and it gets shipped out and
6 it's used outside the state.

7 And so if you think about -- there was a number
8 of different railroads. So if they were repairing, you
9 know, the Reading Railroad's sleeper car, they know it's
10 not coming into California. That's not their territory.

11 The Pennsylvania Railroad, Redding Railroad, New
12 York Railroad. There was a number of railroads. They're
13 not going to go back. They don't, you know, have a
14 business operating in California.

15 So they agreed. And even at the time, the Board
16 of Equalization acknowledged, well, this is going to lower
17 the tax base, but everybody's telling us -- I'm
18 paraphrasing -- everybody's telling us that if you, you
19 know, pass this exclusion, then at least you're not going
20 to penalize these companies for repairing, you know,
21 out-of-state equipment here in the state.

22 And it passed. And -- and that's -- that's the
23 whole purpose. That's what we're doing. That's why we --
24 we reprinted the, you know -- the statute. Because it
25 seems clear that, you know, we're not trying to -- I'm not

1 trying to fit our facts into the law or the law into our
2 facts.

3 It's just that's -- it's -- it's kind of clear
4 from the language. And -- and the language itself is
5 clear enough.

6 But -- and I took that extra step to go see --
7 all right. Well, where'd it come from? And is that -- is
8 that consistent with, you know, our business? And it is
9 consistent.

10 This, you know -- the issue -- this issue was
11 raised in, say -- in 2014 or so. And I -- when I would,
12 you know, do research and I wanted to get, you know, any
13 research -- any fact about it -- I -- because I just
14 wanted to know, am I missing something?

15 So when you Google it and you spend a lot of, you
16 know, time with that, I found that there's a -- a library
17 in Chicago that actually has hundreds of boxes of Pullman
18 Company documents.

19 So after a few months of thinking about it, then
20 I told my boss that I really have to go. I really have to
21 go to Chicago. So I went there with the staff. And we
22 spent two days, you know, requesting boxes from this
23 library.

24 I -- I don't know why they kept -- well -- so the
25 Pullman Company's headquarters was in downtown Chicago.

1 And so, when the company went out of business and
2 they were -- so instead of throwing out the records,
3 apparently they asked the library, "Do you want a bunch of
4 Pullman records?"

5 And it turns out, just from the research I've
6 done over years, railroads are really, you know -- people
7 find it very interesting. So I think that that's part of
8 the reason why -- but anyway --

9 So we went there -- so what one of -- it wasn't
10 hugely productive. But I did learn like, you know, that
11 they do lease -- their business was leasing the sleeper
12 car to the railroads. So there's a number of lease
13 agreements dating back to the 1800's.

14 I mean, the one for the Lehigh Valley Railroad,
15 which is where I'm from, was dated, I think, 1873. So it
16 showed that, you know, that's -- that's what their
17 business was. It was just the -- the sleeper business.

18 They would lease the cars to the railroads. They
19 would staff the cars with porters and, you know,
20 housekeepers, chefs. It was really, you know, it's a
21 luxury kind of a business. So --

22 Q So just to be clear, the -- you referenced some
23 letters and memos between the State Board and the
24 Governor.

25 Are those the same letters and memos that are

1 exhibits in this case?

2 A Yes.

3 Q Okay. So the Judges have them?

4 A Yes.

5 MS. SILVERSTEIN: Okay. Thank you.

6 So I just want to summarize. That was basically
7 the conclusion of our 6009.1 argument. Just to be very
8 clear -- we've said it before -- the statute describes
9 exactly what Olympus does at its repair facility when it
10 repairs out-of-state equipment.

11 It exercises a right over the repair parts for
12 the purpose of incorporating them into the customer's
13 equipment to be transported outside of the state and,
14 thereafter, used solely outside of the state.

15 As you heard, the express purpose for the,
16 legislation for the statute was to encourage companies to
17 have repair facilities in California.

18 We aren't trying to fit the statute that was
19 written for a different purpose into our case. It was
20 written for this purpose. It was written for repairs.

21 CDTFA hasn't provided any coherent reason why the
22 exclusion statute doesn't apply. And the panel should
23 grant Olympus's appeal.

24 I do have some brief things to say about the
25 relief provision and the penalty.

1 Would it be possible to save that until the end?

2 JUDGE LAMBERT: Yeah, you can. You have about
3 18 minutes left in your 45 minutes. So if you want to,
4 like, use any time left, we could add it to the end.

5 MS. SILVERSTEIN: Okay. That would be great.
6 Yeah. Because I really want to focus on the statute.
7 Because we think that should resolve the case and you
8 shouldn't have to reach the other issues.

9 JUDGE LAMBERT: Okay.

10 And CDTFA -- Mr. Smith, you'd probably have the
11 opportunity to respond after that, if -- if we're moving
12 it as well to the end.

13 So does that conclude your presentation at this
14 time?

15 MS. SILVERSTEIN: It does.

16 JUDGE LAMBERT: Okay. Thank you.

17 MR. SMITH: Excuse me. Do -- do we have the
18 opportunity to ask the witness questions?

19 JUDGE LAMBERT: Yeah. You will have the
20 opportunity.

21 MR. SMITH: Thank you.

22 JUDGE LAMBERT: Let me just clarify, first, that
23 on the testimony, Mr. Tobin -- appreciate the statements
24 on the leg. history. We wouldn't consider it to be
25 testimony, per se. But, you know, we'll take it into

1 consideration when making a determination.

2 So, CDTFA -- Mr. Smith, you can ask Mr. Tobin
3 questions if you want.

4 MR. SMITH: Thank you. I just have two
5 questions.

6
7 CROSS-EXAMINATION

8 BY MR. SMITH:

9 Q My first question is does Olympus sell repair
10 parts stored in the San Jose facility?

11 A Sell parts to another -- oh. Sorry.

12 Q Yeah. To, like, a -- just a hospital -- I guess,
13 one of your customers -- do they sell parts?

14 A It's -- if there's not an optional maintenance
15 contract -- oh. Sorry.

16 If there's not an optional maintenance contract,
17 then we would bill -- yeah. We would bill the customer
18 for parts and labor, combined.

19 Q Okay. And my second question is does Olympus use
20 repair parts stored in it's San Jose inventory pursuant to
21 mandatory maintenance contracts?

22 A We use the parts to fix warranty products,
23 which -- yeah. I think it would consider mandatory
24 maintenance contracts.

25 Q Some of those are included in the sale? They're

1 not the optional type?

2 A Say that again.

3 Q Sorry. Some of those warranties are warranties
4 that are included with the sale. That -- that's not
5 optional to the customer? It's just included
6 automatically; right?

7 A Right.

8 MR. SMITH: Okay. Okay. Thank you.

9 JUDGE LAMBERT: Thank you. Thank you.

10 Judge Geary, did you have any questions?

11 JUDGE GEARY: Yes, I do. Thank you.

12 Mr. Tobin, I -- I think you testified that the --
13 the company that you work for has never paid use tax in
14 connection with the parts used to repair the machinery for
15 out-of-state customers; is that correct?

16 THE WITNESS: Right.

17 JUDGE GEARY: So what period of time are we
18 talking about? The statute -- I think somebody referred
19 to 6009.1 as having been first put on the books in '40 --

20 THE WITNESS: 1943.

21 JUDGE GEARY: '43.

22 So for as long as you've been with the company,
23 I'm assuming Olympus has not paid tax on parts that were
24 used to repair machines for out-of-state customers?

25 THE WITNESS: Correct.

1 JUDGE GEARY: And is it -- is it your testimony
2 that the original decision to not pay tax was related to
3 this analysis based on section 6009.1?

4 THE WITNESS: Yeah. So, I mean, the audit -- the
5 prior audits never taxed -- like, when they -- they looked
6 at the -- the optional maintenance contracts. It was
7 always part of the assessment.

8 But they -- if you look at the records -- what
9 they did -- they didn't -- they were only focused on
10 California contracts -- customers.

11 JUDGE GEARY: Your -- your response is an
12 indication to me of what the -- what CDTFA was doing.

13 But is it your testimony that your company's
14 decision to not pay tax on those parts was based upon your
15 company's analysis of the Statute 6009.1?

16 THE WITNESS: Right. Right.

17 JUDGE GEARY: Okay. Initially, when you were
18 giving your testimony -- before you showed the -- the
19 videos today -- I had this vision of these people having
20 to pack up this tower-worth of equipment and send it back.
21 And I -- it boggled my mind that you could do that and get
22 it back in 48 hours.

23 But having seen the videos, it appears that parts
24 of the tower or related parts of the equipment were being
25 sent to you for repairs.

1 Is that a fair --

2 THE WITNESS: Right.

3 JUDGE GEARY: -- characterization?

4 THE WITNESS: Right. Because, as you said, it's
5 a bit of an effort to move the whole tower around. So
6 it's -- generally, they'll -- they'll send in the
7 defective part.

8 And that might be part of the consulting when
9 they call with the service center as far as what they
10 should be sending back. So --

11 JUDGE GEARY: That was going to be my next
12 question.

13 How does the customer know what part to send
14 back?

15 THE WITNESS: I would just -- I would say that it
16 was probably -- I -- I -- what -- what it probably was --
17 that's the reason why they asked them to call the
18 service -- the customer service center, first, before
19 you -- before you do anything as far -- well, before you
20 ship anything, you're supposed to get authority to ship
21 it.

22 JUDGE GEARY: So it's your understanding that
23 somebody at Olympus's customer service center walks
24 through, perhaps, the symptoms that were being experienced
25 by the customer and, based on that information, makes a

1 recommendation regarding what part or parts to return for
2 repair?

3 THE WITNESS: Yeah, I think so.

4 I mean, I would have to confirm that. But I
5 think that the whole -- that's part of the purpose where
6 you have to do that very first step -- call us to --
7 before you ship anything back, call us.

8 JUDGE GEARY: The -- the -- the videos describe
9 the process of repairing two different parts.

10 Would it be fair to assume that -- that,
11 regardless of the part that is returned for repair, the
12 process is basically the same?

13 They complete an on-site diagnosis of the
14 problem. They do the repair. They test the part to make
15 sure that it's working the way that it is supposed to.
16 And then they return it to the customer?

17 THE WITNESS: That's right.

18 JUDGE GEARY: And I believe you answered a
19 question affirmatively that it's always the same part
20 that's returned to the customer -- that is, whatever part
21 is sent to Olympus for repair, Olympus always repairs that
22 part and returns the same one to the customer.

23 Is that the way it works?

24 THE WITNESS: Yes. As far as I know, yeah.

25 JUDGE GEARY: So there's -- there's no instances

1 that you're aware where Olympus has stock parts, for
2 example, that are available to send to a customer in -- in
3 lieu of returning the exact same part that they sent to
4 Olympus for repair?

5 THE WITNESS: There's a small amount of, like, on
6 site -- because there are field engineers that will travel
7 throughout the country. And they can do certain repairs.

8 But it's not -- it's not the major repairs that
9 are done here. It's not the major repairs that happen in
10 San Jose.

11 JUDGE GEARY: There was a question -- a question
12 about consumables.

13 And I believe your testimony was that Olympus
14 pays tax on all consumables, whether those are used on the
15 repair of an -- of a California customer or an
16 out-of-state customer; is that -- is that correct.

17 THE WITNESS: That's right.

18 JUDGE GEARY: Regarding the legislative history
19 research that you undertook with your staff, you -- you've
20 provided some documents that have been admitted as
21 exhibits.

22 I'm -- were those the only documents that you
23 culled from all the documents you reviewed in the course
24 of your research?

25 THE WITNESS: Yeah. When you go through the --

1 the legislative history -- might be -- it was pretty
2 lengthy. But a lot of it was just repeated drafts of, you
3 know, markups, cross-out here and there.

4 So yeah. It's -- what we attached was -- the
5 real substance was that -- like, what the key was -- is
6 those memos that kind of explain things. A lot -- much of
7 the dozens of pages of legislative history is -- might
8 just be the markup.

9 And also -- not necessarily just for -- that bill
10 may have had other sections in it unrelated to 6009.1.
11 And so that -- so the -- there might be a volume, you
12 know, of pages. But -- but, you know, we only focused on
13 the 6009.1-relevant documents.

14 JUDGE GEARY: The company that you hired
15 initially -- you made reference to them -- something about
16 "legislativeintent.com" or something.

17 What was that?

18 THE WITNESS: Legislative Intent, LLC.

19 JUDGE GEARY: Did they provide you a report
20 regarding legislative history on this 6009.1?

21 THE WITNESS: Yeah. It's not -- yes.

22 What they -- or that's what -- I thought they
23 were going to give just purely, you know, here's the bills
24 and that's it. But they do make comments and say, you
25 know, "Think about this. Think about that."

1 They do mention that the bill was presented in
2 the prior congress session in 1942 and said, "So if you
3 don't find what you're looking for in 1943, maybe you can
4 see if there's something in 1942."

5 But the information that was helpful was found
6 in -- in the 1943 in a batch of documents.

7 JUDGE GEARY: The Pullman Company -- I take it --
8 you -- you mentioned Pullman Company a number of times in
9 your testimony.

10 Did you understand the Pullman Company to have
11 been a primary mover in -- in connection with getting this
12 legislation passed?

13 THE WITNESS: Yeah. Because they -- they were
14 mentioned specifically in one of the letters saying that,
15 you know -- and it's probably -- might have been a -- it
16 was an attorney. I'm not sure what his connection was --
17 obviously their representative.

18 And saying that his letter to the Governor --
19 Governor Warren -- he was saying that -- that the
20 exclusion that we're talking about here is best, you
21 know -- the best example of that or a good example of that
22 is the Pullman business that's fixing their train cars --
23 repairing their train cars in California.

24 So they did specifically refer to Pullman.

25 JUDGE GEARY: Was -- was Pullman Company the

1 owner of the cars that were being sent to California for
2 repair?

3 THE WITNESS: The Pullman Company -- there --
4 there's actually two -- there's at least two legal
5 entities.

6 So the -- the sleeper car company was called the
7 Pullman Company. And they have -- if you look at their --
8 there was a tax return in -- in the -- in -- in -- in
9 Newberry, which was a 1926 tax return.

10 And so it shows that you can see that the sleeper
11 car company only had revenue from a sleeper car business.
12 If you look on their balance sheet, you can see the cars
13 on their balance sheet. There was \$200 million in cars.
14 So it was a sizable fleet, let's say. And also the
15 revenue was sizable -- \$83 million back in 1943.

16 So it was -- a few of -- this -- again, if you
17 Google it, you can get other information about it -- there
18 was another legal entity called something like "The
19 Pullman Manufacturing and Repair Business" or something.

20 That's the one that was based out in Richmond in
21 California. That's who was doing the repairs. So when
22 they -- when they did the repairs, it was for the Pullman
23 Company -- for the sleeper car company. Because you can
24 see on the balance sheet they had -- they owned cars.

25 So it wasn't -- it wasn't the Pullman

1 Manufacturing Car company in California. They -- they did
2 not own the cars. They were just doing the service -- the
3 repair service.

4 JUDGE GEARY: And the person who was lobbying --
5 or the entity that was lobbying in favor of the bill that
6 resulted in 6009.1 -- it's your understanding that that
7 entity was the one that was doing the repairs in
8 California?

9 THE WITNESS: Right.

10 JUDGE GEARY: Or the one that was owning the cars
11 and that were being shipped to California?

12 THE WITNESS: That was the one in California.
13 And in -- in the documents, though, they don't -- they
14 don't -- they'll just say "The Pullman --" they just refer
15 to it as "Pullman." They don't specify whether it's the
16 Pullman Company, the sleeper car business, or Pullman, the
17 repair -- manufacturing and repair business.

18 JUDGE GEARY: Okay. Thank you very much. Those
19 were the only questions I had.

20 JUDGE LAMBERT: Thank you, Judge Geary.

21 Judge Ridenour, do you have any questions?

22 JUDGE RIDENOUR: I do not have any questions at
23 this time.

24 JUDGE LAMBERT: Thank you.

25 I have a couple of questions.

1 I was just wondering, Mr. Tobin, if -- you were
2 stating that you had informed this position on 6009.1.
3 And that's the reason for the nonreporting of the -- of
4 the non-California customers.

5 And that was -- that position was formed during
6 the time of the previous audits? Or when did you come to
7 that conclusion?

8 THE WITNESS: So, you know, when the audits were
9 happening, there was a number of, you know, measures they
10 looked at. And so, you know, my staff would work with the
11 auditor to, you know -- on each of these points.

12 And so, when you look at -- so 6009.1 became an
13 issue once the current audit started questioning the
14 taxability of those parts.

15 And I was like, "Well, you never taxed them in
16 the past; so why are you taxing them now?"

17 And so -- yeah. So it's that point when -- it
18 doesn't take long. Because I, you know -- when I go back
19 and I see the e-mails during that time, it was a pretty
20 short turnaround to figure out, yeah, 6009.1 excludes the
21 parts from tax.

22 So as far as, like, this conscious decision that
23 you're asking -- like, I started working there in 1996.
24 And it -- and it was -- was, you know, inherited -- the
25 whole, you know, Tax Department and anything -- any issues

1 associated with it.

2 And so that -- the parts were not really a major
3 issue at all to us when you're only taxing California
4 parts.

5 As soon as you tax all parts, then there's about
6 ten times more tax because our business in California is
7 only eight percent of the whole business. So then he
8 wanted to tax a hundred percent.

9 Then it became a material issue. I was like,
10 "Why -- why now?"

11 And then -- so when you look at it, then I'd see
12 6009.1. And so I even told the auditor, you know, "This
13 would seem to exclude it. I'll -- I'll give you a memo
14 explaining it."

15 And he said, "Well, I'll read it. But it's not
16 going to change my mind," which -- that's true. He didn't
17 change his mind.

18 But it seemed clear from there. And so, you
19 know, we've been led down a couple of paths over the years
20 as far as what their position is.

21 But again, as Amy said, it's not -- they'll refer
22 to 1546. And we don't dispute that. Because if you look
23 at 1546(b)(3)(c), it says "optional maintenance
24 contracts." Yes. That's -- that's what we sell. So
25 that's not the issue.

1 The issue is that they're not taking the next
2 step to figure out, "Well what's -- is there anything
3 excluded?"

4 And that's -- that's pretty much the whole
5 point -- is they're not looking at 6009.1.

6 JUDGE LAMBERT: Thank you, Mr. Tobin.

7 So it seems like you were saying you started
8 looking at 6009.1 during the current audit.

9 So was it discussed -- this issue -- CDTFA -- in
10 the previous audits? And if it wasn't based on 6009.1,
11 what was the basis for the nonreporting of the tax on
12 that -- non-California customers.

13 THE WITNESS: Well, again, they -- this,
14 historically -- because the -- the auditors would audit.
15 And they only taxed the -- so, again, if you're looking
16 for the conscious decision saying, "Oh. This is -- we've
17 done this amount," no.

18 I was like -- when I got there, this is, I mean,
19 ongoing. They -- they -- they were audited -- Olympus was
20 audited for years.

21 And so, when you look at, you know -- that parts
22 issue was tiny in the overall scheme of things. When you
23 look at the -- the measure -- and the measure of tax --
24 for parts in those three audits were between \$200,000 and
25 \$300,000. And that's it for the entire audit period.

1 So if you multiply that by the tax rate, it's --
2 it's really not terribly material.

3 And so that didn't -- there was other issues --
4 "Well, did you get the resale tickets?" -- because we had
5 a -- a camera business at the time.

6 There's a lot -- almost every other measure of
7 tax was more material than the parts. So, no, it didn't
8 get the focus.

9 It's just that, in the current audit, when he's
10 expanded it to include all parts.

11 Oh. And why -- so then I said, "Were we wrong?"
12 Why -- why, you know -- "Why weren't we paying tax on all
13 of this?"

14 And then, when you look at it, you say, "Oh.
15 Well, I imagine it's 6009.1." Because that's what it
16 says -- is that when you're repairing out-of-state
17 customers' property, it's -- it's excluded from use.

18 JUDGE LAMBERT: Thank you, Mr. -- thank you,
19 Mr. Tobin.

20 And I think I just have one question for
21 Ms. Silverstein.

22 In the briefing it goes into this issue of,
23 like -- of stating that 1620 is an interpretive regulation
24 of 6009.1 -- if you recall in your briefing.

25 MS. SILVERSTEIN: Yeah.

1 JUDGE LAMBERT: And also, I -- I was wondering
2 what the -- what the basis for saying it's an interpretive
3 regulation is. And are you saying that 1546 would be as
4 well?

5 And does 1620 -- is that more relevant to 6009.1
6 than 1546?

7 It sounds like you were saying that -- because
8 1620(b)(9) is an interpretive regulation interpreting
9 6009.1, that is more applicable?

10 MS. SILVERSTEIN: Well, yeah. So 1620, if you
11 look at the language -- if you look at -- well, it's
12 Subdivision 9. I think it's -- so what did we --

13 JUDGE GEARY: It's (b)(9), according to the
14 exhibit.

15 MS. SILVERSTEIN: Yeah, (b)(9).

16 The easiest way to find it -- I don't know if you
17 have the Reg. in front of you. We didn't actually
18 reproduce the language -- but if you -- you go up from the
19 bottom of the Reg., (b)(9) says -- it -- it basically
20 parrots that Stat. 6009.1. There are a few words that are
21 different.

22 It says, "Storage and use do not include the
23 keeping, retaining, or exercising any reg. or power over
24 property for the purpose of subsequently transporting it
25 outside the state for use thereafter solely outside the

1 state or for the purpose of being processed, fabricated,
2 or manufactured into, attached to, or incorporated into
3 other property to be transported outside the state and,
4 thereafter, used solely outside the state."

5 So, yes, your Honor. It is our position that
6 1620 is an interpretive reg. of 6009.1. It does more than
7 that, but part of it is interpretive of -- of the statute.

8 And then if you look at the examples, we --
9 that's what we reproduced on -- on the poster.

10 One talks about an engine installed in an
11 aircraft which is flown out of the state for use,
12 thereafter, solely outside the state. And that qualifies
13 for the exclusion.

14 Basically, similar to what Olympus does --
15 inserting a new part into the endoscope -- the piece of
16 the endoscope -- and then sending it outside of the state
17 for use outside of the state.

18 And then, two, also an engine installed in a
19 truck which is transported by rail or air directly out of
20 the state for use thereafter solely outside the state
21 qualifies for the exclusion.

22 So again, the engine's installed in the truck.
23 It goes out of state. It's used out of state. It's
24 excluded under 6009.1, similar to the repair part in this
25 case.

1 With regard to the other regulation, that's not
2 an interpretive regulation of 6009.1 -- the -- the one
3 about the -- the maintenance contract.

4 That just specifically applies to -- I mean, it
5 has other purposes, but the provision that you're asking
6 about, you know, addresses optional maintenance contracts
7 and how the parts used in those, you know -- who's going
8 to be taxable, basically, under different scenarios if
9 there's a tax.

10 So it's relevant here. But it's not -- it -- it
11 doesn't -- it -- it doesn't determine the outcome of this
12 proceeding.

13 And you know, it tells you that if there's a tax,
14 it would be a use tax. But then you have to look at 6009,
15 which is, you know, a statute that would, in any event, be
16 more authoritative than the reg.

17 But 6009 says, under the circumstances, that the
18 part is not -- it's not used, and so there's no tax.

19 Does that answer your question?

20 JUDGE LAMBERT: Yes, Ms. Silverstein. Thank you
21 very much.

22 MS. SILVERSTEIN: Okay.

23 JUDGE LAMBERT: It's appreciated.

24 And now, I believe, we can turn to Mr. Smith.

25 MS. SILVERSTEIN: May --

1 JUDGE LAMBERT: Oh. Sorry.

2 MS. SILVERSTEIN: I just want to clarify one
3 piece of the testimony, if that's possible.

4 JUDGE LAMBERT: Sure.

5 MS. SILVERSTEIN: Okay.

6
7 REDIRECT EXAMINATION

8 BY MS. SILVERSTEIN:

9 Q Mr. Tobin, the -- you testified that the results
10 of these three audits -- well, let's take the first one --
11 was that no use tax was imposed on the repair parts for
12 the out-of-state customers' equipment; is that correct?

13 A Right. Yes.

14 Q And when that -- after you -- that audit was
15 completed and you learned that those parts weren't taxed
16 by -- and then the Board of Equalization.

17 Did Olympus, thereafter, rely on the outcome of
18 that audit to continue to not pay use tax on the repair
19 product -- parts used to repair the out-of-state
20 customer's equipment?

21 A Yes. Essentially, yes.

22 MS. SILVERSTEIN: Okay. That's all I wanted to
23 clarify.

24 JUDGE LAMBERT: Okay. Thank you very much.

25 Mr. Smith, you can proceed with your

1 presentation. We agreed to 20 minutes before. So you can
2 proceed now. Thanks.

3 MR. SMITH: Can I just ask a clarifying question?

4 So part of my presentation is addressing the 6596
5 issue. And I know she hasn't really addressed that yet.
6 So do you want me to do that now? -- you know, my --
7 address that? Or wait until she's addressed that issue?

8 JUDGE LAMBERT: Well, I'll leave it up to you.
9 You could add more later if you want to respond to what
10 she states.

11 MR. SMITH: Okay.

12 JUDGE LAMBERT: But you could just address it
13 now --

14 MR. SMITH: Okay.

15 JUDGE LAMBERT: -- if you want.

16 MR. SMITH: That's fine.

17
18 PRESENTATION

19 MR. SMITH: Good morning.

20 At issue today is whether adjustments to the
21 measure of parts consumed in the optional maintenance
22 contracts are warranted; whether Appellant is entitled to
23 relief under Section 6596 based on prior audit advice; and
24 whether relief of the negligence penalty is warranted.

25 Appellant is a distributor, retailer, and

1 repairer of endoscopes and other devices. During the
2 liability period from April 1, 2008, through September 30,
3 2011, the Appellant offered optional lump-sum maintenance
4 contracts --

5 JUDGE LAMBERT: Mr. Smith, if you could just
6 maybe slow down just a tad, It'll be easier for the
7 stenographer to --

8 MR. SMITH: No problem.

9 JUDGE LAMBERT: -- transcribe. Thanks.

10 MR. SMITH: -- with the sales of endoscopes;
11 under which, Appellant provided parts and labor for any
12 necessary repairs and maintenance.

13 Specifically, Appellant purchased the parts, ex
14 tax, from the manufacturer of the endoscopes, Olympus
15 Medical Systems corporation, a related company located in
16 Tokyo, Japan. And then Appellant stored the parts in a
17 San Jose, California repair facility.

18 Pursuant to its maintenance contracts with its
19 customers, the customer shipped the endoscopes parts to a
20 San Jose repair facility via common carrier, where
21 Appellant inspected and repaired the endoscopes using the
22 parts purchased from Olympus Medical.

23 Appellant then shipped the repaired endoscopes
24 via common carrier back to its customers, who were located
25 within and outside of California.

1 Appellant did not bill its customers for the
2 parts that it installed and did not report the purchase or
3 consumption of the respective parts on its sales and use
4 tax returns.

5 Turning to the law, use tax is imposed on the
6 storage, use, or other consumption of tangible personal
7 property purchased from any retailer for storage, use, or
8 other consumption in the state unless that use is
9 specifically exempted or excluded by statute.

10 Generally, use tax is owed by the person storing,
11 using, or otherwise consuming the property in this state.

12 The term "storage" and "use" do not include
13 keeping, retaining, or exercising of any right or power
14 over tangible personal property for the purpose of
15 subsequently transporting it outside the state for use
16 thereafter solely outside the state.

17 When repair works -- repair work on property is
18 performed under an optional lump-sum maintenance contract
19 that provides for the furnishing of parts, materials, and
20 labor necessary to maintain the property, the repair in
21 regard of the consumer of the parts and materials
22 furnished. That's Regulation 1546 and 1655.

23 If the repairer purchases the property for
24 re-sale or from outside California without paying tax or
25 tax reimbursement on the purchase price, they must report

1 and pay tax upon the cost of such property when the
2 property is used in fulfillment of the optional warranty
3 contract.

4 Here, the Appellant is liable for the use tax.
5 There is no dispute that Appellant purchased the parts at
6 issue ex tax from Olympus medical, brought the repair
7 parts into California, and stored the parts at the repair
8 facility in San Jose.

9 There's no dispute that Appellant's out-of-state
10 customers shipped endoscopes to Appellant in San Jose and
11 that, in accordance with this optional maintenance
12 warranty contracts, Appellant repaired the endoscopes
13 using the parts at issue and then delivered the repaired
14 endoscopes to a common carrier in California for shipment
15 to its customers outside California.

16 Therefore, Appellant is regarded as a consumer of
17 the parts and materials at issue and in accordance with
18 Regulation 1546 Subdivision (b)(3)(C).

19 And because Appellant used the parts and
20 materials at the repair facility in San Jose, Appellant
21 consumed the property in California. The consumption of
22 tangible personal property constitutes a taxable use.

23 Consequently, Appellant is liable for use tax on
24 the consumption in California for the parts at issue.

25 Various Business Tax Law Guide Annotations

1 support this, including Annotation 315.0215, which states
2 that "when a repairer is regarded as the consumer of the
3 parts that it furnishes, tax applies to the repairer's
4 purchase of the parts installed in California, even if the
5 property's thereafter shipped to the customer outside
6 California."

7 In addition, Annotation 315.0766 states that
8 "even when the part is not installed at all but simply
9 shipped directly to the customer out-of-state, use tax
10 applies to the repairer's use of the property if it is
11 delivered to a common carrier in California."

12 Section 60- -- Section -- sorry -- Section 6009.1
13 does not exclude Appellant's taxable use of the parts in
14 this state because Appellant made a complete use of the
15 parts in California, Appellant's use of the parts was
16 complete upon installation into the customer's equipment
17 or, at the latest, upon delivery to the common carrier in
18 the state.

19 Appellant's use of the parts was complete and
20 Section 6009.1 excludes use in California for the purpose
21 of subsequent and exclusive use out of state. Here,
22 Appellant made no use of the parts out of state
23 whatsoever; and therefore, 6009.1 is inapplicable.

24 This conclusion is supported by the same
25 annotations I cited previously. And specifically,

1 315.0766 specifically states that -- that 6009.1 does not
2 apply when the repair part is delivered to a common
3 carrier in California for shipment out of state.

4 More importantly, this conclusion is directly
5 supported by the California Court of Appeals decision in
6 Yamaha v. BOE, which held up, "when a gift is completed,
7 upon delivery to a common carrier for shipment out of
8 state, 6009.1 doesn't apply."

9 As here, the Court held that 6009.1 does not
10 apply when a person's use of the property ends upon
11 shipment out of state.

12 Regarding Appellant's claim that Regulation 1546
13 merely clarifies when a particular sale should be regarded
14 as a sales tax or use tax transaction and that Regulation
15 1546 does not actually indicate when property is used or
16 consumed, we agree that Regulation 1546 provides only that
17 the repairer is regarded as the consumer of the parts
18 furnished under an optional maintenance contract.

19 However, Regulation 1500 Subdivision (c)(3)
20 specifically provides that, when a person is a consumer of
21 tangible personal property, a sale to such person is a
22 retail sale to which either the sales or use tax applies.

23 Thus Regulation 1546, together with Regulation
24 1500, make clear that the consumption or property
25 qualifies as a taxable use. And a taxable use includes a

1 physical use of property by repairer under an optional
2 maintenance contract.

3 Finally, the examples in Regulation 1620 involve
4 use including installation of a repair part in state for
5 the purpose of subsequent use out of state by that
6 taxpayer.

7 Those examples are not applicable to parts
8 consumed under optional warranty maintenance contracts
9 where there is no subsequent use -- where there is no
10 subsequent out-of-state use by the taxpayer.

11 Based on the foregoing, the repair parts at issue
12 furnished and sold by Appellant in California to fulfill
13 its contractual obligations under its optional maintenance
14 warranty contracts are subject to tax.

15 Turning to Appellant's contention that it
16 reasonably relied on erroneous written advice given by the
17 Department during the prior audits, if -- if the
18 Department finds that a person's failure to make a timely
19 return or payment was due to the person's reasonable
20 reliance on written advice --

21 (Reporter admonition)

22 MR. SMITH: Sure.

23 -- the person may be relieved of the taxes
24 imposed and any penalty or interest.

25 If a previous audit of the person requesting

1 relief contained written evidence demonstrating that the
2 issue in question was examined either on a sample or
3 actual basis, such evidence will be considered written
4 advice from the Department.

5 With respect to the first audit with a period
6 ending March 31, 1999, limited records were available.
7 The only records available consists of Verification
8 Comments, Audit Schedule 12, and Audit Schedule 12-F, and
9 a copy of the Reaudit Report dated February 21, 2003,
10 provided by Appellant. And these are Exhibit B, pages 41
11 to 53.

12 The Verification Comments specifically indicate
13 that Appellant did not provide the Department with any
14 records related to the materials and parts consumed in
15 optional maintenance contracts and that it estimated the
16 amount for parts consumed based upon monthly contract
17 billings as listed in Audit Schedule F.

18 Thus the Verification Comments in Schedule F show
19 that there is no dispute that the Department estimated
20 measure of tax -- measure of use tax due on the parts
21 consumed under optional maintenance warranty contracts in
22 the first audit.

23 Plus the Department did not erroneously advise
24 the Appellant in writing that the parts and materials are
25 not subject to tax in the first audit.

1 Regarding the second audit, Appellant submitted a
2 portion of a December 19, 2006 Reaudit Report, and a
3 portion of the Verification Comments, and copy of Audit
4 Schedule B of the audit work papers showing that the
5 Department assessed use tax on parts consumed under
6 optional maintenance warranty contracts related to various
7 California customers. This is Exhibit B, pages 54 to 64.

8 Initially, we know that neither the Audit Report,
9 the Verification Comments, nor Audit Schedule B contain
10 any statement by the Department specifically advising that
11 the parts installed in San Jose and ultimately shipped
12 outside of California are excluded from tax.

13 Instead the Verification Comments specifically
14 indicate that, pursuant to Regulation 1546, the Appellant
15 is a consumer of parts used in the performance of its
16 service contracts, and there is no mention in the comments
17 that this advice is limited to those parts shipped within
18 California.

19 Further, according to a letter issued by the
20 Department, it specifically requested that Appellant
21 submit a list of total parts used under its optional
22 maintenance warranty contracts.

23 And it advised the Appellant that the parts
24 furnished in connection with these warranties were
25 taxable. In the letter, the Department also directed

1 Appellant to various annotations that make this point.

2 In addition, Audit Schedule 12-B-2 appears to
3 consist of schedules produced by Appellant, which are
4 comprised solely of transactions with California custom --
5 customers.

6 Plus the schedules corroborate the Department's
7 claim that it simply requested a schedule of parts
8 consumed in California, that Appellant provided a schedule
9 of parts related only to California customers, and that
10 the Department accepted this information.

11 Thus there is no basis to conclude that Appellant
12 is entitled to 6596 relief as a result of the second
13 audit.

14 Finally, regarding the third audit for the period
15 ending December 31, 2007, Appellant submitted a Reaudit
16 Report dated August 10, 2011; a portion of the audit
17 Verification Comments; Audit Schedule I; and a memo dated
18 January 11, 2010, from the Department to Appellant
19 requesting a listing of all California customers with
20 maintenance contracts. This is Exhibit B, pages 65 to 69.

21 As with the previous audits -- audits, neither
22 the Audit Report, Verification Comments, or Audit Schedule
23 state that use tax does not apply to parts installed and
24 ultimately shipped outside of California.

25 In addition, the Verification Comments indicate

1 that Appellant had trouble locating records relating to
2 its parts consumed under optional maintenance warranty
3 plans. And as a result, both the Department and Appellant
4 agreed to use an error percentage established during the
5 previous audit of Appellant's account.

6 Thus, although the January 11, 2010 memo from the
7 Department appears to request records related to
8 Appellant's California customers, the Verification
9 Comments in Schedule I show the Appellant did not provide
10 the Department with any records relating to its parts
11 consumed under its optional warranty contracts.

12 Consequently, since the Department did not
13 examine the Appellant's use of parts consumed under its
14 optional warranty contracts and since the Department did
15 not indicate in any of the available audit work papers
16 that the parts used to repair endoscopes ultimately
17 shipped outside California were excluded from tax,
18 Appellant is not entitled to relief of tax at issue under
19 Section 6596, based on this third audit.

20 And to the extent that the Appellant argues that
21 Department must have known that Appellant repaired
22 endoscopes belonging to out-of-state customers, that is
23 not the standard for relief under Section 6569.

24 That law only authorizes relief from tax when
25 there is actual written evidence demonstrating that the

1 issue in question was examined. Therefore, Appellant is
2 not entitled to relief of tax under Section 6596.

3 Finally, turning to the negligence penalty,
4 Revenue and Taxation Code Section 6484 provides for the
5 imposition of 10 percent penalty if any part of the
6 deficiency was due to negligence or intentional disregard
7 of the law or authorized -- authorized rules and
8 regulations.

9 Negligence -- negligence is defined as "a failure
10 to do what a reasonable and prudent -- prudent person
11 would do under the same or similar circumstances."

12 This was Appellant's fourth audit. According to
13 the respective Reaudit Reports for the previous audits,
14 the Department assessed use tax on unreported costs of
15 parts consumed on each contract.

16 All of the -- and although the Department
17 previously assessed use tax only on the parts used to
18 repair property belonging to California customers, the
19 evidence shows that Appellant failed to report any use tax
20 on its parts consumed on optional maintenance contracts
21 during the period at issue.

22 Thus even if we assume that Appellant reasonably
23 believed that its use of the parts installed in endoscopes
24 belonging to out-of-state customers were excluded from
25 tax, Appellant's continued failure to report its purchase

1 of parts used to repair endoscopes belonging to in-state
2 customers is strong evidence of negligence.

3 Moreover, the Reaudit Report shows that, as in
4 the current audit, Appellant failed to report purchases of
5 fixed assets subject to use tax, purchases of consumable
6 supplies, and the use of loaner equipment.

7 Appellant's continued failure -- failure to
8 correct these errors is further evidence of negligence.
9 Thus a negligence penalty should be imposed.

10 This concludes my presentation. Thank you.

11 JUDGE LAMBERT: Thank you, Mr. Smith. I'm going
12 to turn to the panel now to see if they have any
13 questions.

14 Judge Geary, did you have any questions?

15 JUDGE GEARY: No. Thank you.

16 JUDGE LAMBERT: And, Judge Ridenour, do you have
17 any questions?

18 JUDGE RIDENOUR: Also no. Thank you.

19 JUDGE LAMBERT: Thanks.

20 I have a couple of questions. I was just wanting
21 to clarify. On the Notice of Determination, it says that
22 the negligence penalty was a -- was imposed based on
23 both -- either 6478 or 6484.

24 So I just want to clarify that -- that -- which
25 one it is. Would it be 6484?

1 MR. SMITH: It would be 6484.

2 JUDGE LAMBERT: Thanks.

3 And -- and just to clarify on 6009.1, CDTFA's
4 position that that exclusion could apply in some
5 circumstances to an optional maintenance contract -- or is
6 it not something that would ever apply?

7 Or is there circumstances where it would apply?

8 There's the annotation that was 315.0766, which
9 was discussing that it would tax when applying -- when the
10 installation occurs outside the state by company.

11 But if the parts are shipped to the out-of-state
12 customers for installation by the customer, tax applies at
13 the time of the shipment.

14 MR. CLAREMON: I -- I can address that.

15 JUDGE LAMBERT: Okay.

16 MR. CLAREMON: This is Scott Claremon.

17 Yeah. I think, with regard to those annotations,
18 and similarly -- similarly, with regard to the Yamaha
19 holding, it depends on where the use ends.

20 So in the examples provided in those annotations,
21 when the use ends upon shipment within the State, when the
22 use by the taxpayer ends, then tax applies.

23 But I think in those examples if, for instance,
24 pursuant to an optional maintenance contract, a repair
25 part stored in California was shipped to the repairer's

1 facility out of state and then the repair was done out of
2 state and then given to the customer there -- in that
3 case, it was shipped and used thereafter by the repairer,
4 the taxpayer.

5 So yes. There are circumstances where, under an
6 optional maintenance contract, property stored in
7 California could not be subject to tax pursuant to RTC
8 6009.1. But not in the facts presented here.

9 JUDGE LAMBERT: Okay. Thank you, Mr. Claremon,
10 for clarifying.

11 And just on the negligence penalty, I had a
12 question. Under Regulation 1703, I believe there's
13 certain factors that it discusses and if these apply --
14 whether the taxpayer was previously audit -- audited.

15 And in this case, the taxpayer was, but it
16 doesn't seem like that issue was raised. Or maybe, if no
17 one was aware of it, would that factor -- couldn't it
18 still be the same in terms of negligence?

19 If -- if, in this case, it kind of seems like
20 they weren't really previously audited on this -- this
21 specific issue as opposed to -- so it may be comparable to
22 being audited for the first time.

23 Would you comment on that possibility -- or if
24 that would -- how you look at it.

25 MR. SMITH: Yeah. I think the -- the point I was

1 trying to make is that they were audited on the in-state
2 contracts previously, and they were assessed a deficiency.

3 And they, despite being assessed a deficiency
4 three times previously on those in-state contracts -- they
5 continued, in this audit, to not report that correctly.

6 MR. CLAREMON: And -- and I would add, I think
7 that goes back to our statement with regard to the
8 applicability of Section 6596 relief.

9 They were told that they owed tax on all of the
10 repair parts for optional maintenance contracts that they
11 presented to us.

12 So particularly in that first Audit, Schedule
13 12-F schedules all the optional maintenance contract
14 transactions that were presented to us. There's no
15 comment that other transactions were excluded from that.

16 So 12-F shows everything. And everything that
17 was presented to us was a California transaction. And we
18 said that was all taxable.

19 So every -- they were given the advice that for
20 all the -- all the transactions that they presented to us,
21 tax was owed. And so then they failed to follow that
22 advice in subsequent audits.

23 JUDGE LAMBERT: Thank you, Mr. Smith and
24 Mr. Claremon.

25 I don't have any more questions at this time.

1 So we could turn to -- Ms. Silverstein, if you
2 wanted to continue your presentation. I believe you
3 wanted -- we -- we added -- we added some earlier time to
4 the -- your closing remarks -- remarks. And I have it
5 down that -- you have around 20 minutes.

6 And, you know, if CDTFA wants to give some
7 brief -- briefly respond to anything, I'll ask them after
8 that.

9 And then we -- I'll ask the panel, also, if they
10 have any questions. So you -- you can proceed with your
11 final remarks. You have 20 minutes. Thanks.

12 MS. SILVERSTEIN: Okay. I'd also like to respond
13 to their arguments about 6009.1 first.

14 JUDGE LAMBERT: You can just include that in
15 your -- in your presentation.

16 MS. SILVERSTEIN: Okay.

17 JUDGE LAMBERT: Thanks.

18
19 CLOSING ARGUMENT

20 MS. SILVERSTEIN: All right. So I think I heard
21 them make two arguments with respect to 6009.1 not
22 applying.

23 The first one is that there was the -- the repair
24 in California was a use in California. And to me that's
25 circular and doesn't take into account 6009.1.

1 Because the activity -- or the steps in the
2 repair are exactly what 6009.1 describes -- incorporating
3 or attaching a part to other tangible personal property
4 for the purpose of shipping it out of state.

5 And so -- and we know that 6009.1, from the
6 legislative history, was enacted to address repairs. So I
7 don't think -- you know, it's -- it's basically just
8 ignoring the statute to say "repair is a use," when the
9 statute says, essentially, repair is not a use.

10 So that argument, I think, doesn't work.

11 The other argument that CDTFA makes is that
12 the -- the -- Olympus did not use the property outside of
13 the state. They shipped it from California, and then, you
14 know, the customer was using it outside of the state.

15 Well that argument reads words into the statute.
16 It's not what the statute says. The statute says that
17 they performed the repair -- or -- or they -- let's see
18 how does it -- that the exercise of -- of power over the
19 tangible property -- the repair part -- was for the
20 purpose of being attached or incorporated into the
21 tangible property -- that's the repair -- to be
22 transported outside of the state and thereafter used
23 solely outside of the state.

24 It says nothing about who has to use it outside
25 of the state.

1 What it's looking at is when the property's
2 incorporated into the -- the -- the customer's product,
3 was the purpose to attach it and to transport it outside
4 of the state for use solely outside of the state.

5 Clearly, that's satisfied because they did
6 transport it outside of the state for use outside of the
7 state. It doesn't matter whose use outside of the state
8 it is. Because the statute doesn't say either customer or
9 taxpayer -- repairer.

10 Either one would be fine. It just has to be for
11 the purpose of using it solely outside of the state. To
12 confine the statute to use by the repairer would read
13 words into the statute, which obviously is not permitted
14 under principles of the statutory construction.

15 So then CDTFA says, "Well, there are annotations
16 on point that confirm this."

17 The first point I want to make is that
18 annotations, in general, are very weak authority. They
19 don't state all the facts. They're very terse. They
20 were -- perhaps in this case -- the BOE's position based
21 on BOE's understanding of the facts at the time they were
22 written.

23 So you know, in court, certainly -- and I assume
24 the same is here too -- they're, you know -- they can be
25 considered, but they're -- they're not strong authority.

1 And I wanted to get to this. There's a case I
2 believe is stronger authority. But before I get there,
3 they cite two annotations:

4 One of them we address in our brief. That is --
5 let's see -- 315.0215. And I think what we say in our
6 brief is adequate to rebut its applicability here.

7 But just, very briefly, what we say is that
8 there's a key sentence that says that tax applies to the
9 repairman's purchase of the parts. And so, basically,
10 what the annotation is saying is that sales tax applies to
11 the transaction.

12 And so it's our position that -- well, and -- and
13 therefore, the repairman purchased the parts inside of
14 California, which is not our facts. And to the extent
15 that's it's about sales tax, 6009.1 doesn't apply to sales
16 tax.

17 So it's our position that that's inapplicable.
18 And that's in our brief if you want to go back to that.

19 For some reason, we didn't address the other one
20 in our brief. And I'm not sure if they're raising it for
21 the first time. It probably did come up at some point in
22 this case.

23 I -- I have it here. And I -- I looked at it.
24 Basically, I -- I do think it makes that same point about
25 the use needing to be use by the taxpayer-repairer and not

1 use by a different company that they're repairing it for.

2 But again, as I mentioned, it's the same response
3 that that's not what the statute says. It's an improper
4 interpretation of the statute.

5 One other -- other thing I forgot to mention is,
6 Bob testified, the Pullman Company did have two entities.
7 So we believe the facts there are analogous to our facts.

8 Even though they were commonly owned, of course,
9 for sales and use tax purposes -- and really, in general,
10 under the law -- separate entities are respected as
11 separate entities. So that shouldn't be viewed as any
12 different than the separate entities here.

13 We don't need to rely on that. That's, you know,
14 extra information that's not in the legislative history.
15 I think it's an interesting fact. But as I said, what is
16 determinative is the language of the statute and applying
17 principles of statutory construction and the words that
18 the statute support -- application, regardless of who uses
19 the property outside of California.

20 I think that gets us to the relief provision.
21 We're asking for relief under 6596 as a result of the --
22 because of the results of the audit.

23 I want to make very clear, we're not conceding
24 anything by making this argument. We don't and will never
25 agree that 6009.1 doesn't apply here. But to the extent

1 that the panel disagrees, in the alternative, we do ask
2 for relief under 6596.

3 I think that the -- the CDTFA's presentation of,
4 like, kind of what facts are relevant and how they
5 presented it is not faithful to the terms of the
6 regulation.

7 If you look at the regulation, there's a specific
8 section that discusses written advice provided in a prior
9 audit. And it doesn't at all require that, you know,
10 there's any sort of statement that, in this case, repair
11 parts for out-of-state customers' equipment is not subject
12 to use tax. No statement like that needs to be, you
13 know -- needs to be in the audit results.

14 Basically, they say it has to contain written
15 evidence which demonstrate that the issue in question was
16 examined.

17 And then, its written advice -- or the -- the
18 requirement of the advice is satisfied when the activity
19 or transaction in question -- when the -- the Audit Report
20 shows that the activity or transaction in question was
21 properly reported and no amount was due, that's sufficient
22 for a finding for relief from liability -- is what the
23 statute -- or what the regulation says.

24 This is in Subdivision (c) about 10 lines down --
25 or 20 lines down from the top.

1 So basically, what -- in order to give relief to
2 Olympus under this statute and regulation, this Board
3 needs to find that, in one of the three audits -- it
4 doesn't have to be all three -- that CDTFA -- or I'm sorry
5 -- BOE at the time examined the issue, and then the result
6 was that no tax was due.

7 And so it's our position that the -- the issue
8 that was examined is whether repair parts used at the San
9 Jose facility are taxable. And clearly that issue was
10 examined.

11 We know that, ultimately, BOE taxed the repair
12 parts for California customers and didn't tax the repair
13 parts for the non-California customers.

14 So the issue of "Are repair parts taxable?" was
15 examined. And the result was there was no tax on the
16 repair parts for the non-California customer repairs.

17 So it's our position that that satisfies the
18 terms of 6596. And relief should be -- should be
19 permitted or afforded.

20 But to the extent that, you know, the question
21 is, you know, "Did they know" -- did -- "Did BOE know
22 there were non-California customers?" You know, there was
23 kind of an implication that Olympus, you know, wasn't
24 forthcoming.

25 I believe that there's clear evidence in each of

1 the audits that BOE did make a -- a conscious decision to
2 tax only the parts for the California customer repairs.

3 In the first audit, there's a -- a statement
4 about having looked -- or, you know, reviewed records or
5 sales reported by state. And it -- to me, that indicates
6 that they saw, you know, the sales by state; right?

7 And so they saw the sales for California
8 customers and non-California customers and then chose to
9 tax only the repairs -- repair parts used for the
10 non-California customers. I believe that's in the second
11 audit too.

12 But in the third audit, they specifically ask for
13 the California sales. And so, you know, there's an
14 implication there that they weren't asking for all
15 sales -- I mean, not an implication -- it's clear that
16 there -- there is an express statement; they weren't
17 asking for all sales.

18 So in -- in choosing to ask just for the
19 California sales, it's indicative of them, you know,
20 making a conscious decision not to tax the repair parts
21 for the out-of-state customer repairs.

22 And, you know, there's no question that they knew
23 that there were repairs performed for out-of-state
24 customers. That -- I don't think that was even disputed.
25 And so, you know, why would they ask for just the

1 California sales?

2 The only plausible reason is that they intend --
3 that they intended to tax only the California sales and
4 not the out-of-state sales or repairs -- I should say --
5 repairs for in-state customers and not the repairs for
6 out-of-state customers.

7 And I think that gets us to the negligence
8 penalty. And here, to me, the issue is whether the
9 negligence penalty can be applied on, you know, just the
10 portion of the deficiency that related to the repairs for
11 California customers and not on the portion of the
12 deficiency that related to repairs for the out-of-state
13 customers.

14 Their reasons they didn't report and pay tax on
15 the -- the repair parts and the consumables used with
16 respect -- well, consumables -- all consumables were --
17 but repair parts used with respect to the California
18 customers' repairs.

19 There's reasons they did that. That was
20 basically de minimus. And the time and effort to do that
21 was, you know -- frankly, they knew that it was going to
22 be audited. They knew they were going to pay it. And
23 they always did pay it. And they never disputed it.

24 But it's our position that it would be
25 inequitable to impose the penalty for, you know -- based

1 on the -- the taxpayer's behavior with respect to this
2 very small amount to -- and then impose the penalty on
3 this very large amount -- and that's the tax that relates
4 to the out-of-state customers' repairs.

5 The CDTFA's own manual indicates that there's
6 discretion to apply the penalty to only a portion of the
7 deficiency when it would be inequitable to apply it to all
8 of it.

9 And to the extent that they have discretion, it's
10 our position that the -- the panel also has discretion to
11 interpret it that way. And, you know, just based on the
12 pure equities, they obviously were not negligent with
13 respect to not paying tax on the repair parts for the
14 out-of-state customers repairs.

15 There's a statute directly on point. They -- the
16 CD -- BOE had never taxed those before. It was their
17 understanding that they were not taxable.

18 I know there was questions that were asked
19 about -- "Well, when did you come to the 6009.1 position?"

20 I don't think that that's the pertinent question
21 with respect to either 6596 or the negligence penalty.
22 Because, you know, basically they were basing their
23 understanding on these transactions not being subject to
24 use tax.

25 Actually, I should say, we don't really know all

1 the reasons. I mean, it predates Bob. It's very possible
2 that they came to the conclusion that 6009.1 applies. But
3 what's really pertinent here is that -- is the -- the
4 non-taxation, time after time, by BOE.

5 And so, you know, this panel might or might not
6 decide that the issue was, you know -- was audited. We
7 think it was. But surely, relying on the outcome of those
8 audits precludes any finding of negligence. So -- with
9 respect to those transactions.

10 So that's our position on that. And we urge the
11 panel to use the CDTFA manual's guidance -- that they can
12 apply the penalty to only a portion of the deficiency
13 based only on an inequity.

14 That's the conclusion of my presentation for now,
15 I think. I'm happy to answer any questions. And then if
16 I could reserve one last rebuttal, I'd appreciate it.

17 JUDGE LAMBERT: Yeah. Sure. I'll have C --
18 CDTFA, if you have any brief remarks -- anything to add?

19 MR. CLAREMON: We -- we would just reiterate
20 that, even in the context of an audit, and even -- it --
21 it still requires written evidence that the issue was
22 examined.

23 And here, particularly with the first audit --
24 that when you read those Verification Comments, it appears
25 that they began the examination of the reported sales,

1 which were the total sales or sales made in California,
2 there were various exclusions and exemptions that are
3 listed out of -- sales, and interstate commerce was not
4 one of them.

5 And once they began the examination of California
6 sales to determine whether they had failed to erroneously
7 report its sales as ex tax -- that is when they separated
8 out the optional maintenance contracts into transactions
9 to Schedule 12-F.

10 So the -- the appearance being that they were
11 separating out from the other California sales.

12 And again, there is no comment that 12-F excludes
13 transactions they looked at. There's no comment that they
14 only listed the California transactions on 12-F but did
15 not list out-of-state transactions. There's no comment
16 that it only lists the taxable transactions.

17 So the written evidence in those audit work
18 papers is that the only transactions examined with regard
19 to optional maintenance contracts were California
20 contracts.

21 JUDGE LAMBERT: Thank you, Mr. Claremon.

22 I'll just turn to my panel and see if they have
23 any questions for either party at this time.

24 Judge Geary, did you have any questions?

25 JUDGE GEARY: No questions. Thank you.

1 JUDGE LAMBERT: And, Judge Ridenour, do you have
2 any questions?

3 JUDGE RIDENOUR: No questions. Thank you.

4 JUDGE LAMBERT: Okay. I have -- I have a
5 question.

6 I was just wanting clarified that -- maybe CDTFA
7 could clarify -- but the negligence penalty is applying to
8 both -- entire assessment.

9 Is that both California and non-California
10 customers?

11 MR. SMITH: Yes. That is correct.

12 JUDGE LAMBERT: Okay. And -- thank you.

13 And, Ms. Silverstein, I believe you were touching
14 on this -- that you -- you're saying the negligence
15 penalty should not apply to the non-California customers
16 versus the California customers.

17 Is that what you were stating?

18 MS. SILVERSTEIN: That's correct.

19 JUDGE LAMBERT: Okay. And then, when you were
20 explaining why -- was the -- were the California customers
21 reported then?

22 Or were you saying it wasn't material? And if
23 they do, they were going to be audited?

24 MS. SILVERSTEIN: Well --

25 JUDGE LAMBERT: I guess, if the -- if the

1 position was that -- that only the non-California
2 customers are not taxed, then why wouldn't -- wouldn't the
3 California customers' tax be reported, then, in the first
4 place?

5 MS. SILVERSTEIN: We concede that the tax -- the
6 tax is due on the repair parts for the California
7 customers' equipment and also that it was not reported.

8 I'm never going to say my client was negligent.
9 But we're not disputing that portion of the negligence
10 penalty.

11 JUDGE LAMBERT: Okay. You're not disputing the
12 California customers' part.

13 MS. SILVERSTEIN: Correct.

14 But we're saying that should not then be parlayed
15 into negligence for the entire assessment because the
16 Cal- -- the tax on the California customers' repair parts
17 is -- it was -- roughly, if you look at -- across all the
18 audit periods -- it's about \$200,000 to \$2 million.

19 So the statute doesn't prohibit -- the negligence
20 penalty statute doesn't prohibit applying the negligence
21 penalty to a portion of the assessment. And CDTFA's own
22 guidance indicates that it shouldn't be applied to the
23 whole assessment if it would be inequitable to do so.

24 And my argument -- and I firmly believe this --
25 is that there's no argument that there's -- that my client

1 was negligent with respect to the tax on the repair parts
2 for the out-of-state customers.

3 JUDGE LAMBERT: Okay. Thank you for clarifying.

4 One more question -- or maybe a couple. I'll
5 keep this brief, hopefully. Just that -- I want to
6 clarify.

7 Are you stating that the Regulation 1564 is just
8 not applicable? And would there be a situation where, you
9 know, 6009.1 would apply?

10 Because we saw these videos of certain types of
11 repairs. And I think your -- maybe you could clarify --
12 but the point was that it's kind of, like, a minor repair.
13 It's not really using the device.

14 So are you say -- saying there's certain types of
15 different repairs where it would be more of a functional
16 use versus these kinds of repairs?

17 Or what -- what would be the significance of the
18 type of repair?

19 MS. SILVERSTEIN: No. That the -- the -- the
20 operative fact -- or the -- the -- the determinative fact
21 is the shipment outside of the state for use outside of
22 the state.

23 So 1546 is relevant because it applies to
24 optional maintenance contracts. And it -- its function is
25 to say that when there's a repair, the -- if there's going

1 to be a tax, it's going to be a use tax on the repairer.

2 And so, in the case of repairs for California
3 customers' equipment -- that the -- that regulation would
4 result in -- you know, the -- the regulation says that's a
5 use in California because it's a use in California and
6 there's no exclusion, then use tax applies.

7 So that's how we all get to the position we agree
8 on that Cal- -- the tax was due on the repair parts with
9 respect to the repairs of the California customers'
10 equipment.

11 But that reg. doesn't say tax applies all the
12 time. It just says that there's -- the repairer used --
13 is -- is considered to have used the -- the -- the repair
14 parts.

15 Then you go to the statute to the extent that the
16 repair parts were repaired for the purpose of shipping
17 them outside the state and then for use outside the state,
18 6009.1 comes into play.

19 And it basically trumps everything. And it
20 provides that those transactions are excluded from use and
21 so there's no use tax.

22 JUDGE LAMBERT: Okay. Thank you.

23 MS. SILVERSTEIN: Okay.

24 JUDGE LAMBERT: Thank you, Ms. Silverstein.

25 MS. SILVERSTEIN: Okay.

1 JUDGE LAMBERT: And at this point, was there more
2 that you wanted to present -- maybe just briefly
3 perhaps -- like, to add? I think you wanted to add a
4 little bit more?

5
6 FURTHER CLOSING ARGUMENT

7 MS. SILVERSTEIN: I think we actually made all of
8 our points. I -- I -- I just -- I would urge the panel to
9 examine those audit reports. Because I don't see anywhere
10 that, in the first audit at least, the taxpayer reported
11 on the California sales.

12 And, in any event -- to the extent that that's
13 CDTFA's position -- they haven't addressed the other two
14 audits other than saying, "Well, those auditors -- or the
15 subsequent auditors must have just followed what the
16 earlier auditors did."

17 If you take a step back and you look at this
18 entire period -- three audits of, you know, roughly 12
19 years of so -- and they're full audits. They're not just
20 audits of -- of this issue. They're audits of all the
21 sales and use tax of the company -- the auditors, you
22 know, clearly understood this was a worldwide company.

23 They knew about the San Jose company. They saw,
24 you know, sales reports, you know, by destination. And,
25 you know, each one of those auditors determined, you

1 know -- or at least did not tax the repair parts for the
2 out-of-state customers' equipment.

3 So, you know -- I mean to -- to think -- and the
4 last auditor specifically asked just -- or asked for
5 California sales indicating that they were making a
6 determination they didn't need the out-of-state sales.

7 So it's our position that this does constitute
8 written advice -- that the written advice is, you know, no
9 change. This does constitute written advice, under the
10 regulation, that those items were not taxable.

11 But just to sum up, obviously our main argument
12 that we believe is -- this whole case should be resolved
13 on is 6009.1.

14 I don't really need to reiterate everything I
15 said because I think it's very clear from the description
16 of the repair process and the videos that the repair
17 process is removing the defective part, replacing it with
18 the new repair part that was exactly the same all for the
19 purpose of shipping it back to the customer for use
20 outside of the state.

21 These repairs follow exactly the terms of 6009.1.
22 The statute couldn't be more clear that it excludes these
23 repair parts from use. Excluding them from use means
24 there's no use tax.

25 And -- oh. I -- I did forget to mention the case

1 that I think is more -- I know is more determinative than
2 the reg. or the annotations. It's cited in our papers.
3 It's the Atchison case.

4 And it, you know, basically involved a railroad
5 where a part was -- a railroad was repaired in California.
6 And it was a special kind of repair part that could only
7 be used on certain types of tracks. And the -- the train
8 was then transported outside of the -- outside of the
9 state.

10 And the taxpayer argued that the trains came back
11 to California. The taxpayer argued that the repair part
12 was never used in California. And the reason they said
13 that is because the repair -- the repair part could only
14 be used on certain kinds of tracks that were outside of
15 California.

16 So technically, it couldn't be used in
17 California. But it was part of the train. And the
18 outcome in the court case was that the taxpayer lost
19 because the -- the train was came back to California and
20 was used in California.

21 But I think the reason this case is really
22 important is because it does interpret 6009.1. It
23 interprets it in the context of -- of a repair -- exactly,
24 you know, our facts.

25 And there's no indication that the repair itself

1 was a use that in and of itself would be, you know -- make
2 the -- the repair part subject to tax. The only question
3 was whether the repair part was actually used in
4 California after the fact.

5 So it's our position that, you know, it's the
6 closest case on point. There aren't any other cases. It
7 does support our case. And it's certainly more
8 authoritative than annotations.

9 So to sum it all up, really, all the panel needs
10 to do is read the statute, apply the facts to the statute,
11 and we urge the panel to grant the taxpayer's appeal.

12 Thank you.

13 JUDGE LAMBERT: Thank you, Ms. Silverstein.

14 If there's nothing further, I'm going to conclude
15 the hearing.

16 So I want to thank both parties -- CDTFA and
17 Ms. Silverstein and Mr. Tobin -- for testifying. And we
18 will issue a written opinion within 100 days.

19 And the record is now closed.

20 Thank you.

21 (Proceedings concluded at 11:28 a.m.)
22
23
24
25

1 REPORTER'S CERTIFICATION

2
3 I, Sarah M. Tuman, RPR, CSR No. 14463, a
4 Certified Shorthand Reporter in and for the State of
5 California, do hereby certify:

6 That the foregoing proceedings were taken before
7 me at the time and place herein set forth; that any
8 witnesses in the foregoing proceedings, prior to
9 testifying, were duly sworn; that a record of the
10 proceedings was made by me using machine shorthand, which
11 was thereafter transcribed under my direction; that the
12 foregoing transcript is a true record of the testimony
13 given.

14 Further, that if the foregoing pertains to the
15 original transcript of a deposition in a federal case,
16 before completion of the proceedings, review of the
17 transcript ☐ was ☒ was not requested.

18 I further certify I am neither financially
19 interested in the action nor a relative or employee of any
20 attorney or party to this action.

21 IN WITNESS WHEREOF, I have this date subscribed
22 my name.

23 Dated: November 7, 2022

Sarah M. Tuman, CSR, RPR, CSR No. 14463

Certified Shorthand Reporter

For The State of California

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