BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:	
REDWOOD MEMORIAL HOSPITAL, INC., APPELLANT.	CASE NO. 21037436

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Tuesday, January 24, 2023

Reported by:

Maria Esquivel-Parkinson,
CSR No. 10621, RPR

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TRANSCRIPT OF PROCEEDINGS, taken at 400 R Street, Sacramento, California, commencing at 9:30 a.m. and concluding at 10:55 a.m. on Tuesday, January 24, 2023, reported by Maria Esquivel-Parkinson, CSR No. 10621, RPR, a Certified Shorthand Reporter in and for the State of California.

APPEARANCES:

PANEL MEMBERS:

Teresa Stanley, Lead ALJ
Andrew Kwee
Mike Le

FOR THE APPELLANT:

Randy Ferris, Esq.
Mark Stefan, Representative
Sara Gaudreau, Representative

FOR THE CDTFA:

OFFICE OF TAX APPEALS
400 R Street
Sacramento, California

Amanda Jacobs
Scott Claremont, Tax Counsel
Jason Parker, Hearing Representative

I N D E X

E X H I B I T S

(Appellant's Exhibits 1 through 16 were admitted at page 10)

(CDTFA's Exhibits A through F were admitted at page 10)

PRESENTATION

Sacramento, California; Tuesday, January 24, 2023

9:30 a.m.

ALJ STANLEY: Again, this is appeal -- appeals -- appeal of Redwood Memorial Hospital, Inc. The case number is 21037436. The date is January 24th, 2023, and the time is about 9:30 a.m. here in Sacramento, California.

Again, I'm Judge Teresa Stanley, and Judge Andrew Kwee and Judge Mike Le are also on the panel. I will conduct the proceedings, but the panel will equally deliberate and issue a written opinion within a hundred days after the record closes.

Let's have everybody identify themselves for the record, starting with Appellant.

MR. FERRIS: Randy Ferris, Ernst & Young, for Appellant.

MR. STEFAN: Mark Stefan, Ernst & Young for Appellant.

MS. GAUDREAU: Sara Gaudreau, Ernst & Young, for Appellant.

ALJ STANLEY: And CDTFA.

MS. JACOBS: Amanda Jacobs, Tax Counsel III, with the California Department of Tax and Fee Administration.

MR. CLAREMONT: Scott Claremont with the CDTFA.

MR. PARKER: And Jason Parker, chief of headquarters operations bureau with CDTFA.

ALJ STANLEY: Okay. And I -- I just want everybody to know that they can -- they can just jump in if you have any questions about how the proceedings are going or if you think I've missed something.

I'm going to welcome everyone to the Office of Tax Appeals, or OTA as we lovingly call it. OTA in an independent agency that has no affiliation with CDTFA or any other tax agency. OTA is not a court, but we're an independent appeals agency staffed with our own tax experts.

The only evidence in OTA's record is what was submitted in this appeal, which all three judges have reviewed.

The proceedings are being livestreamed on YouTube. Our stenographer Ms. Esquivel-Parkinson is recording the proceeding so, once again, speak directly into your microphone, speak loudly and clearly, and hopefully she can catch every word.

The issues to be decided in this appeal are as follows: The issue is whether Appellant is entitled to a refund of the tax and/or tax reimbursement it paid on its purchases of tangible personal property provided to

patients covered by Medicare Part A. And Appellant in their prehearing conference statement listed five subissues that I'm going to go ahead and read into the record so that we can make sure that we consider those in our deliberations and opinion.

It's Appellants understanding that the following principal material facts and issues are in dispute. Number one, whether for periods prior to January 1st, 2019, title passage clauses and contracts between medical service facilities and Medicare Part A patients are relevant with respect to meeting the requirements of the exemption provided under Revenue and Taxation Code Section 6381 and regulation Section 1614(f).

And number two, whether a requirement for such title passage clauses with Medicare Part A patients would effectively and improperly invalidate the Medicare Part A exemption because such a requirement would impermissibly treat Medicare Part A patients as federal instrumentalities.

Number three, whether if title passage clauses with Medicare Part A patients are not relevant for operating the Medicare Part A exemption for periods prior to January 1st, 2019, a requirement that title passage clauses exists in contracts between medical

service facilities and the United States Government would effectively and improperly invalidate the exemption because such title passage clauses have never existed since the exemption first became operative in 1966.

Number four, whether Regulation Section 1503(b) and 1591(f)(2) are interpretive regulations pursuant to the classifications set forth in the Yamaha Corp. of America vs. the State Board of Equalization and are invalid to the extent they cannot be harmonized with the Medicare Part A exemption provided under Revenue and Taxation Code Section 6381 and Regulation 1614(f).

And lastly number five, whether any indicia of an intent to make an exempt sale of medical supplies to the United States Government under Medicare Part A is required other than identifying the subject medical supplies to the United States Government as part of the established Medicare Part A reimbursement procedures and receiving a corresponding payment from the United States government.

Mr. Ferris, does this accurately represent the issues as you see them?

MR. FERRIS: Yes, Judge Stanley.

ALJ STANLEY: And, Ms. Jacobs, does the CDTFA agree that those are the issues that have been raised?

MS. JACOBS: Yes, we agree.

ALJ STANLEY: Okay. We also had some prehearing stipulations in this case, and I'm going to read those and make sure that the parties still agree.

Number one, the parties agree that no title passage clauses exist between Appellant and Medicare Part A patients for the claim period at issue and that no title passage clauses exist between Appellant and the United States Government for the claim period at issue. That -- since this was proposed by Appellant I'll ask you, Ms. Jacobs, does the Department still agree to that?

MS. JACOBS: We do.

ALJ STANLEY: Okay. And CDTFA -- well, I won't -- I won't need to read into the record the parts that CDTFA did not agree to, but after the prehearing conference CDTFA reviewed transactions in Appellant's Exhibits 9 through 16 and agreed that those exhibits are sufficient to establish that Appellant was charged tax or tax reimbursement and that it paid the tax or tax reimbursement to its vendors in these seven particular transactions.

Is that correct, Ms. Jacobs?

MS. JACOBS: That's correct.

ALJ STANLEY: Okay.

MR. FERRIS: Judge Stanley, I should probably add that if you add up all of the tax amounts for those seven transactions, the amount is $50.58.

ALJ STANLEY: Okay. Thank you for the clarification or addition. So at the hearing -- at the prehearing conference, we had Appellant's Exhibits 1 through 16 and CDTFA did not object, so if there's no objection today, Ms. Jacobs?

MS. JACOBS: No objection.

ALJ STANLEY: Those will be entered into evidence.

(Appellant's Exhibits 1 through 16 admitted.)

ALJ STANLEY: Despite the minutes and orders that stated only eight of them would be.

So CDTFA submitted Exhibits A through F, and Appellant did not object to those exhibits.

Is that still accurate, Mr. Ferris?

MR. FERRIS: Yes, it is.

ALJ STANLEY: Okay.

(CDTFA's Exhibits A through F admitted.)

ALJ STANLEY: And I want to point out for the record and for the public that neither party is presenting any witnesses today, so there will only be a presentation and no witnesses will be sworn in under oath or affirmation. We're going to start with

Appellant's presentation.

So, Mr. Ferris, when you're ready, you may proceed.

PRESENTATION

MR. FERRIS, Attorney for Appellant:

Thank you. Honorable panel, Appellant is seeking --

(Reporter interrupted)

MR. FERRIS: Honorable panel, Appellant is seeking a refund for tax paid purchases resold deductions arising from tax and reimbursement. Appellant paid to its vendors on purchases of medical supply items. Appellant later sold these items to the federal government in nontaxable transactions pursuant to the Medicare Part A exemption provided under Revenue and Taxation Code Section 6381 and Sales and Use Tax Regulation 1614, subdivision (f).

The Department denied Appellant's refund because over the years since the party exemption first became operative in 1966, the Department has inadvertently lost connection with the statutory basis for the Part A exemption unmoored from the statutory basis for the Part A exemption, the Department now clings to irrelevant language about patient title passage clauses in regulation 1503(b)(2)(C) in hopes

that the OTA will defer to an administrative error made by the Department's staff back in 2001.

Appellant respectfully urges the OTA not to defer to this administrative error and to compel the Department to return to the statutory mooring of Section 6381 as implemented by Regulation 1614(f).

There's an old story about the importance of questioning the assumptions behind traditional approaches that speaks to how the Department became unmoored from the statutory basis of the party exemption. In the story a young girl notices her mother cutting off the ends of a roast before putting it into a pot to cook in the oven. The child had seen her mother do this before when preparing pot roast dinners, but she had never thought to ask her mother about it. This time she did.

Her mom replied, "That's a great question. You know, I don't know why I always cut the ends off, but that's the way your grandma always did it and I picked it up from her. You should call your grandma and ask her."

So the curious girl called up her grandma and got the same response. Grandma cut off the pot roast ends because she had noticed that her mother had always cut the ends off. Fortunately, the curious and

persistent girl was blessed with longevity in her family. So she called up her great grandmother. To the girls delight, the great grandmother did not say that she cut the ends off because that's the way her mother always did it, nor did she offer some explanation like, "I believe the meat would become more flavorful that way." Rather, the great grandmother responded, "When your great grandfather and I had our first apartment, we had a small kitchen with a very small oven and the pot roast wouldn't fit in the oven unless I cut the ends off first."

So how did the Department become unmoored from Section 6381, the statutory basis of the Part A exemption resulting in the 2001 staff error that asserted the title passage clauses with Part A patients were relevant to the operation of the Part A exemption? Or, in the folksy language of the pot roast story, how did it come to pass that the Department started cutting off the ends of the pot roast? A bit of historical context is pertinent here.

At the time the existence of the Part A exemption was first acknowledged in 1966 by Annotation 505.0820, the rule, since 1933, had been that medical service facilities made retail sales of tangible personal property, or TPP, when they made separately

stated charges for TPP on their billing documents. That's why the 1966 annotation provided that the Part A exemption was available for all TPP identified to the federal government for billing purposes under Part A for which payment was made by the federal government.

This 1966 annotation makes it clear that the basis of the exemption is the existence of direct contracts between the federal government and the medical service facilities serving Part A patients and that the Part A patients are not being treated as federal instrumentalities. If Medicare patients were federal instrumentalities then Part -- Medicare Part B transactions would also be eligible for exemption, which they are clearly not.

The Department's confusion apparently started around 1970 when, without any reference to Part A transactions or to Section 6381, the Department modified the 1933 rule with a new rule under Regulation 1503. This new rule provided that medical service facilities made retail sales of TPP when they made separately stated charges both for TPP and for charges to administer the separately stated TPP to a patient. The annotation cited by Department's Exhibit F make it clear that during this time staff understandably focused on how patients were being billed to determine whether a

retail sale of TPP had occurred or not. Unfortunately, as discussed on in detail on pages 72 and 73 of Appellant's Exhibit 2., this patient billing focus began to taint the way staff started analyzing the requirements for the Part A exemption.

Annotation 300.0130 is the most salient example of this tainted analysis. Thus staff started focusing on patient billing when analyzing the availability of the Part A exemption without considering whether it was proper to treat Part A patients as federal instrumentalities. And just like that, the ends of the pot roast were chopped off.

Having lost the tether to Section 6381, the staff error that ultimately occurred in 2001 was somewhat understandable. In 2001 staff proposed to abandon the administered versus nonadministered rule promulgated in 1970 and to replace it with the title passage clause rule that is currently found in Regulation 1503(b)(2)(c).

Title passage clauses have never existed in the Part A contracts between the federal government and participating medical service facilities. So when the question arose during the 2001 interested parties process as to whether the proposed title passage clause rule could unintentionally abrogate the Part A

exemption, as explained in Department's Exhibit F, staff's proposed solution to this problem was to suggest that medical service facilities could operate the Part A exemption by, quote, Including an explicit clause in the contract between the facility and the patient transferring title to medical supply items to the patient, end quote.

In other words, mom had seen what grandma had done with the mistaken focus on patient billing and handed this patient-focused approach down to the next generation with the improper solution of suggesting that title passage clauses with Part A patients could somehow be relevant to operating the Part A exemption.

And so here we are now, 20 -- over 20 years later at a hearing where the OTA is being asked to defer to staff's 2001 error. The Department's unmooring from Section 6381 as at the statutory basis for the Part A exemption is manifestly illustrated by the rulemaking histories of regulations 1503 and 1591.

As reflected by the reference sections that precede each of the Department's publicly available Sales and Use Tax Regulations, regulations 1503 and 1591 do not reference Section 6381. Only Regulation 1614 references Section 6381 because Regulation 1614(f) is the true quasi-legislative touchstone. Regulation

1614(f) is the quasi-legislative regulation that in 1980 officially codified the Part A exemption first acknowledged in 1966 by Annotation 505.0820.

Regulation 1614(f) makes it clear that Medicare patients cannot be treated as federal instrumentalities by emphasizing that Part B transactions are not eligible for exemption. Again, this is because the basis for the exemption is the direct contract with the federal government under Part A. The exemption is not based on treating Part A patients as federal instrumentalities. Even more telling, when the Department amended Regulations 1503 and 1591 in the year 2021 to address staff's concerns about how the Part A exemption was being administered, the Department made no changes to the quasi-legislative Medicare Part A exemption provision set forth in the Regulation 1614(f).

Now, it should be noted that even though Footnote 16 of the appeals bureau's initial decision indicates that Part A patients cannot be treated as federal instrumentalities and even though the appeals bureau's supplemental decision rejecting using title passage clauses with Part A patients to operate -- to operate the Part A exemption, notwithstanding that, at the prehearing conference the Department was unwilling to concede that Part A patients cannot be treated as

federal instrumentalities.

It should also be noted that the Department's Exhibit F cites and quotes the same U.S. Supreme Court cases that Appellant relies on with regard to the extremely narrow circumstances under which a person or entity can be considered to be a federal instrumentality. Per the holding of United States v. New Mexico, Part A patients could only be federal instrumentalities if they cannot be realistically viewed as separate entities for purposes of operating the exemption. That's why the appeals bureau's supplemental decision was correctly adamant that Part A patients could not be conflated with the federal government. And this is also why the appeals bureau rejected the usage of title passage clauses to operate the Part A exemption.

All this raises the following obvious question: If Part A patients are not federal instrumentalities, why is the Department now defending the position that the Part A exemption operates when direct sales of TPP are made to Part A patients through express title patient -- express title passage clauses with Part A patients? Perhaps the Department was unwilling to concede the Part A patients are not federal instrumentalities because the Department is concerned

that if this panel considers the federal instrumentality issue to be relevant, the Department is unlikely to prevail on the merits. In other words, the Department's reluctance to engage on the federal instrumentality issue might be the Department's way of attempting to have its chopped up pot roast and eat it too.

As discussed in more detail in Appellant's briefs, under the classification set forth in the California Supreme Court's Yamaha decision, Regulation 1614(f) is a quasi-legislative regulation because it involves a discretionary rulemaking action to effectuate the purpose of Section 6381. Section 6381 provides an exemption only for direct retail sales of TPP to the U.S. Government and its agencies and instrumentalities.

Section 6381 was enacted in 1943 and does not expressly address the application of tax to transactions involving medical patients insured by a federal program like Medicare Part A. Medicare Parts A and B did not come into existence until 23 years after Section 6381 was enacted. Thus to effectuate the purpose of Section 6381, the Department used quasi-legislative authority to mandate the transactions that could theoretically be considered to be sales of TPP to patients insured under Part A must instead be considered to be direct exempt sales to the federal government by operation of law.

In contrast, 21 years after the Part A exemption was officially codified in Regulation 1614(f) when the Department promulgated Regulation 1503(b)(2) in 2001, the Department was merely interpreting the general application of the true object test set forth in Regulation 1501 as applied to medical service facilities. In fact, Regulation 1501 concludes with the statement, quote, Examples of service enterprises and regulations pertaining thereto will be found in regulations which follow, end quote.

Given its close proximity to Regulation 1501 in the California Code of Regulations, no doubt exists that Regulation 1503(b) is further interpreting the application of the true object test to the activities of medical service facilities. As explained by the Supreme Court in Yamaha, a regulation that construes another regulation is an interpretive regulation. Accordingly, Regulation 1503(b) must be an interpretive regulation, not a quasi-legislative regulation. The OTA must follow the regulatory classifications established by the Supreme Court in Yamaha, and, if a conflict exists, must give greater authoritative weight to the quasi-legislative regulations.

When the OTA issued its precedential opinion in Talavera in 2020, the OTA held that it cannot declare

quasi-legislative regulations invalid and must treat them with the dignity of statutes. Because regulation 1614(f) is a quasi-legislative regulation and Regulation 1503(b)(2) is an interpretive regulation, the OTA is precluded from deferring to the 2001 error of Department's staff on which the Department's position in the instant matter is based.

The OTA has the authority to invalidate the application of Regulation 1503(b)(2) to Part A transactions to the extent it conflicts with Section 6381 and Regulation 1614(f) because Regulation 1503 is merely an interpretive regulation. This is so because the OTA's own Regulation 301.04(a) is clear that the OTA only lacks the jurisdiction to invalidate the statutes and, per Talavera quasi-legislative regulations. However, in this particular case, the OTA can uphold the rule of law without having to invalidate any provision of Regulation 1503(b)(2). Let me explain.

It is -- it is one thing to look at a Part A transaction and say, okay. I see a transfer of possession, whether constructive or actual, to a Part A patient with consideration being paid by the federal government. I could consider this to be an intent to make the sale of TPP to a Part A patient with third-party consideration being paid by the federal

government, but Regulation 1614(f) tells us that even though I could theoretically characterize the transaction as a sale to the Part A patient third-party Section 6381 mandates that I, instead, consider the transaction to be a direct sale to the federal government with title passing directly to the federal government by operation of law.

This approach which is faithful to Section 6381 and Regulation 1614(f) avoids treating the Part A patient as a federal instrumentality. This approach just acknowledges that the -- that the transaction could be analyzed in more than one way, but that Section 6381 mandates that the transaction be treated as a direct exempt sale to the federal government because of the Part A contracts between the federal government and the participating medical service facilities.

In contrast, given that title passage clauses have never existed between participating medical service facilities and the federal government, it is quite another thing to say that the Part A exemption will only operate if express title passage clauses exist between Part A patients and medical service facilities.

Under this alternative scenario, there are not two ways to analyze the facts. Here we have an unambiguous direct transfer of title to TPP to Part A

patients that is then deemed to be a sale to the federal government. Such a result would only be appropriate if Part A patients were federal instrumentalities, but they are not. This approach is not faithful to Section 6381 and Regulation 1614(f).

As discussed in more detail in Appellant's briefs, there is a way that regulations 1614(f), 1503(b)(2), and 1591(f)(2)(A) can all be harmonized without negating the Part A exemption provided under Section 6381. Regulation 1503 provides rules for when medical services facilities are consumers and for when they are retailers. Regulation 1503(b)(1) says that one needs to look at subdivision (b)(2) which is comprised of subparagraphs (A) through (D) to determine when medical service -- when a medical service facility is acting as a retailer. Subparagraph (b)(2)B) has no relevance to the Part A exemption because this provision only addresses certain sales of TPP to discharge patients, for example items like wheelchairs and crutches, who will then use the TPP off the premises of the subject medical service facility.

Part -- Part A only applies to inpatient care. To the extent transactions addressed by subparagraph (b)(2)(B) are paid for by the federal government, such sales would be taxable under Part B of the Medicare Act

if the transaction is not otherwise exempt. Thus subparagraph (b)(2)(B) is inapplicable to Part A transactions.

Subparagraph (b)(2)(D) is also inapplicable to the instant appeal. This provision expressly provides that it only addresses transactions occurring on and after January 1st, 2019. The claim period at issue is July 1st, 2013, through December 31st, 2018. Accordingly, none of the transactions in dispute could potentially be affected by subparagraph (b)(2)(D).

So what about the Department's misguided pot roast recipe found in (b)(2)(C) which focuses on the existence of title passage clauses to determine whether a sale has occurred? Even though the Department was unwilling to concede this point at the prehearing conference, the Department knows that title passage clauses have never existed between medical service facilities and the federal government. That is why staff's erroneous solution in 2001 was to improperly suggest that medical service facilities could operate the Part A exemption by entering into express title passage clauses with their Part A patients.

In other words, staff was well aware that title passage clauses with the federal government under Part A had never been an option. Staff's erroneous solution

proposed in 2001 is inapplicable because Part A patients are not federal instrumentalities. It should also be noted that the appeals bureau expressly rejected this erroneous solution in faithfulness to the well-established canons of construction that preclude relying on plain language interpretations that lead to absurd results. So subparagraphs (C) and (D) cannot be reasonably harmonized with Section 6381 and Regulation 1614(f). That leaves subparagraph (b)(2)(A) which provides a medical service facility is the retailer of property furnished to persons other than residents and patients for a charge.

This is exactly what happens when a participating medical service facility makes a direct exempt sale to the federal government under Part A. In short, only subparagraph (b)(2)(A) can be properly harmonized with both Regulation 1614(f) and Regulation 1591(f)(2)(A) without illegally treating Part A patients as federal instrumentalities in contradiction to the statutory authority of 6381.

Putting all of this together, any transfer of TPP to a Part A patient with consideration paid by the federal government could be analyzed in more than one way. Regulation 1614(f) tells us that even though we could theoretically characterize the transaction as a

sale to the Part A patient with third-party consideration paid by the federal government, Section 6381 mandates that we, instead, consider the transaction to be a direct sale to the federal government.

This result is also consistent with the rule that treats medical service facilities as retailers under Regulation 1503(b)(2)(A). Moreover, this approach has the virtue in interpreting the regulations at issue in context harmonizing to the fullest extent possible all provisions relating to the same subject matter. The Department's focus on subparagraph (b)(2)(C) does not provide a reasonable path to harmonization because it contradicts the statutory basis of Regulation 1614(f) by treating Part A patients as federal instrumentalities.

Finally, under the Department's harmonization approach, any transfer of TPP -- any transfer of possession of TPP to Part A patients, whether actual, constructive, joint, or temporary, is sufficient indicia of the requisite intent to make a direct exempt sale to the federal government under Part A.

Using the broadest possible concept of transfer of possession is consistent with the statutory amendments the Department made to Regulation 1591 in 1999, which are now reflected in subdivision (f)(2)(A). The referenced section of Regulation 1591 makes it clear

that Regulation 1591 is based, in part, on Section 6006, which provides that any transfer of possession in any manner or by any means whatsoever is sufficient for a sale to occur. That is why the 1999 amendment found in Regulation 1591(f)(2)(A) delineates such broad categories of TPP eligible for the Part A exemption, namely all medicines, devices, appliances and supplies in which payment is made under Part A.

It would be inconsistent with the broad categories of eligible TPP to limit the indicia of intent to make direct exempt sales to the federal government under Part A to the likely negligible amount of transactions where actual sole possession of TPP is fully and irrevocably transferred to Part A patients.

In sum, with respect to the operation of the Part A exemption, to avoid absurd results like effectively negating the exemption, the interpretive regulations 1503(b)(2) and 1591(f)(2)(A) must always be construed so that they harmonize with the quasi-legislative Regulation 1614(f) and the statutory basis for the exemption found in 6381.

Appellant's harmonization approach is reasonable because it does not treat Part A patients as federal instrumentalities and does not unduly restrict the availability of the Part A exemption when medical

service facilities indicate their intent to make a direct exempt sale to the federal government by transferring possession of a medical supply item to a Part A patient.

The Department's harmonization approach -- the Department's harmonization approach is in direct conflict with Section 6381 and must be rejected. Accordingly, Appellant respectfully asks that the OTA reverse the Department's action in this matter and grant Appellant's refund. This concludes Appellant's opening statement.

ALJ STANLEY: Okay. Thank you, Mr. Ferris.

Judge Kwee, do you have any questions?

ALJ KWEE: Could you go to Judge Le first and then come back to me, please.

ALJ STANLEY: Sure.

Judge Le, do you have any questions for Appellant?

ALJ LE: No questions at this time.

ALJ STANLEY: Judge Kwee, do you need a minute still?

ALJ KWEE: Okay. Just to make sure I'm understanding, are you also arguing that 1503(b)(2)(C) is invalid and then making, I guess, an additional -- additional argument that the regulation can be

harmonized with 1614 so, like, you're making two alternative arguments? Or were you only saying that the latter, that we could harmonize it with the approach that you --

MR. FERRIS: Right. Well, yeah. Appellant is saying that (b)(2)(C) is irrelevant to Part A transactions. Right? And the only reasons why it is there is because of the staff error made in 2001 where they suggested that title passage clauses with patients could operate the Part A exemption.

So we believe that it is irrelevant to Part A because Part A is -- is 1614(f) is -- clear that the sale that's exempt is a direct sale to the United States government. So a solution that involves setting up an entirely separate retail transaction with the patient that is then deemed to be a sale to the federal government, that is treating the patient as a federal instrumentality improperly.

So it's either irrelevant or to the extent -- and I guess what we're saying is to the extent OTA thinks it is relevant, it needs -- even if it may be relevant to non Part A transactions, right, the OTA should invalidate it as applied to Part A transactions because that approach is completely inconsistent with 1614(f) and 6381. So I don't know if I'm answering your

question or not.

ALJ KWEE: Okay. I think that helps clarify it. So on the instance I think your main, primary position is that this Regulation 1503 provision doesn't apply to Medicare Part A, but to the extent that OTA were to find that it does apply, then because this is interpretive and 1614 is quasi-legislative, you'd ask us to invalidate it to the extent of Part A Medicare under, I guess, that would be the Savemart case which -- where the Board determined that an interpretive regulation was invalid. So I guess that would be the authority for OTA to invalidate a portion of 1503. Is that -- I guess --

MR. FERRIS: That's correct. And again, invalid as applied, you know, to Part A transactions.

ALJ KWEE: Right.

MR. FERRIS: But I think if the OTA focuses on (b)(2)(A) as the correct harmonization approach, the (b)(2)(C) can be left alone. It doesn't apply to Part A transactions because it's describing a sale that could never occur under 1614(f), so it -- so it clearly has no factual application to a Part A transaction.

ALJ KWEE: Okay. And looks like there's been a couple of approaches that were taken prior to 2001. You had the administered nonadministered, then we have the (b)(2)(C). And then I guess after 2019 we have

(b)(2)(D) where it looks at possession. Do you know the reasoning? Was there any change in the -- from my understanding of what you were saying, there's no change in the law that resulted in the change in the approach taken on the regulation and that's why you were giving the example of the pot roast?

MR. FERRIS: Correct. Yeah. And, in fact, I think what happened with the 2021 amendments makes it clear that the Department also thinks that an error occurred in 2001 and that's why they want to change the focus to be more on possession. But they're making that change because they realize that the 2001 suggestion that title passage clauses with Part A patients operating the Part A exemption was not the correct solution, and that's why they're making the change that they're making where they're basically saying the title passage clause doesn't have any real substance, and so, therefore, we're going to add possession as the indicator of the sale. But even then they're still treating the -- the Part A patient effectively as a federal instrumentality because they're very focused on a sale by transfer of possession to the Part A patient; whereas, what Appellant is saying is that transfer of possession is the indicia of the intent to make a sale under 1614(f) a direct sale to the federal government.

It's not -- it's not a proxy sale.

Again, the transaction can be characterized in multiple ways. You could view it as a direct sale to the patient with third-party consideration paid by the federal government. But 1614(f) says no, you can't. That would only be correct if Medicare patients are federal instrumentalities. They're not. That's why Part B doesn't have any exemption because there -- you have Medicare patients. And, again, you can have third-party consideration being paid by the federal government, but those are not exempt because there is no direct contract with the federal government and the hospitals with Part B.

So it -- I think that Exhibit F and what they've done with their 2021 amendments actually corroborates Appellant's position that the 2001 solution was not correct, it was an error, and it was -- that error is based on the patient-focused billing approach that staff started using after the 1970 amendments to 1503. Right? And then that patient focus just kind of bled into staff's consciousness, I guess. And so when the question came up, what are we -- in 2001 we're getting rid of administered/nonadministered and now we're coming up with this new rule about title passage clauses, how does that effect Part A. And then staff's

solution at that time because their minds were steeped in this patient-billing focus, right, they just said, well, just make it title passage clause with your Medicare Part A patients. That will solve your problem if you want to operate the exemption. But that's because staff had lost its mooring, its connection to the actual statutory basis of the exemption, which is 6381.

You know, and if staff had truly been aware of the touchstone of 6381, they would have amended 1614(f) at the same time that they amended 1503 and 1591. They didn't. And that's because they have this blind spot about where the exemption comes from. It comes from 6381. And that's -- that's what Appellant is calling that. Appellant appreciates that it's a big deal for the OTA to consider whether or not the Department has been on the wrong path for over 50 years. We appreciate that that is a big deal. But I think the record's clear that they have been on the wrong path since after 1970 and they have been focused on the patient as a federal instrumentality, and that's improper.

ALJ KWEE: Right. And I guess looking at it from Appellant's perspective, you're asking us to look at, you know, the indicia which is the transfer, the possession, and the direct payment by the government. I

guess that kind of -- that seems to be I feel like at issue there. I mean, is that a, you know, transfer of, you know, a sale like a possession in lieu of title aspect? I don't know. That's just another hard area I guess to --

MR. FERRIS: Yeah. It's -- it is difficult. There's always been a rule, right, for what is the -- what's the indicia of an intent to make a sale of tangible personal property by a medical service facility. From 1933 to 1970, the indicia was did you separately state the TPP and charge for it in your billing documents. That was the indicia. And when that happened, the idea has to be that title to that tangible personal property transferred to the patient. All right.

In 1970 the indicia was changed to show that you had an intent. To make a sale, you had to separately state the TPP. And separately state an administration service charge related to that TPP. Then in 2001 the indicia was changed again to focus on title passage clauses. And that may be well and good with respect to non-Part A transactions, but it is not well and it is not good and it is not proper to apply that type of indicia to make a sale with actual explicit title passage clauses to Part A patients as -- you know,

that -- that doesn't work because it turns the Part A patient into a federal instrumentality. It can't do that.

So Appellant is aware that there's always been something -- some sort of sign of indicia. And I guess with a hat tip to the Department's 2021 amendments, we think it is, you know, proper to look at the transfer of possession, again, with the broad concept of what that might mean, a transfer of possession to -- to part -- to the Part A patient as the indicia of the intent to make that direct sale to the United States government.

And, again, it has the virtue also of excluding things like items of TPP that are always under the, you know, exclusive control and possession of medical staff. Like surgical gloves, right? There's never going to be any indicia of an intent to make a sale of those surgical gloves through the transfer of possession to a Part A patient. We're -- we're appreciative that the Department has concerns about an overbroad application of items of tangible personal property that could be considered to be direct sales to the federal government under Part A.

So the -- using the concept of possession and transfer of possession, again, broadly to the Part A patient, I think does -- is consistent with the true

historical background to how medical service facilities have been taxed. And, you know, again, sometimes they're consumers and sometimes they're retailers. And there's always been a rule about what's the indicia of the intent to shift from being the consumer to being the retailer.

And so Appellant believes that its -- its approach to that indicia to -- to make a sale is -- it's -- is much sounder and more consistent and completely consistent with Regulation 1614(f) and 6381, whereas, the title passage clauses are not.

ALJ KWEE: Okay. Thank you. I will turn it back to Judge Stanley.

ALJ STANLEY: Thank you. I -- I had a similar question about the harmonization versus invalidation of regulations, so I don't need that question answered any further, but I did wonder about your point with the '21 -- 2021 amendments. Do you -- did you review the legislative history to see if there's anything in there that would enlighten us about why the Department made those amendments?

MR. FERRIS: I think -- I mean, the Department, I'm sure, will address that themselves, but it's -- Exhibit F makes it clear that they -- they think that the solution of 2001 to focus on patient title -- title

passage clauses was -- was not correct because they don't think patient title clauses have sufficient substance. That's what they say in Exhibit F.

ALJ STANLEY: Okay. Thank you.

And, Judge Le, you don't have any follow-up questions?

ALJ LE: I do not. Thank you.

ALJ STANLEY: Okay. Then let's turn it over to the Department for their presentation. You may proceed when you're ready, Ms. Jacobs.

PRESENTATION

MS. JACOBS, Tax Counsel:

Good morning. There we go.

Appellant, a California corporation, operated a 25-bed critical care access hospital which rendered medical services to patients insured under Medicare Part A. The tangible personal property, or TPP, at issue in this case is not medicine as defined by Section 6369(b), but rather medical equipment and supplies.

Appellant claims that paid tax or tax reimbursement on the TPP and that the TPP was furnished or used in a provision of services to patients insured under Medicare Part A. During the claim period of July 1st, 2013, through December 31st, 2018, it is undisputed that none of Appellant's contracts with its

patients or with US government contained a title passage clause. The issue in this appeal, as stated in the prehearing conference minutes and orders, is whether Appellant is entitled to a refund of a tax and/or tax reimbursement it paid on its purchases of TPP provided to patients covered by Medicare Part A, or stated differently, whether Appellant consumed or resold the TPP to the U.S. Government in connection with services rendered to its Medicare Part A patients during the liability period.

Regulation 1503 sets forth the application of tax to medical service facilities, including hospitals. 1503(b)(1) states, "Operative April 1st, 2001, except as provided in subdivision (b)(2) medical service facilities are service providers to their patients and residents, including patients and residents insured pursuant to Part A of the Medicare Act, and are the consumers of tangible personal property furnished in connection with those services."

Subdivision (b)(2)(C) goes on to state, quote, a medical service facility is the retailer of any property furnished in connection with its medical services if its contract with the medical service facility's resident or patient or other customer specifically provides that title to the subject tangible

personal property passes to the resident or patient or other customer. When the contract has a provision passing title to the subject tangible personal property to the resident or patient or other customer, the medical services facility may purchase such property for resale, and tax applies to the charge by the medical service facility unless its sale is otherwise exempt from tax, end quote.

We note that these rules are generally to the benefit of medical service facilities in that it simplifies their transactions with patients and sets the measure of tax on the cost to them unless they specifically intended to be a retailer.

As described in Exhibit D, the version of Regulation 1503 in effect prior to April 1st, 2001, distinguishes -- distinguished between whether medical service facilities made separately stated charges for administered and nonadministered items, and the Department and interested parties agreed to the default rulemaking medical service facilities the consumer of the TPP was preferrable. See Exhibit D, page 8.

As you know, according to Section 6381 sales of TPP to U.S. Government are exempt from tax. With regard to TPP furnished to patients insured under Medicare Part A, Regulation 1591(f)(2)(A) states, Tax does not apply

to the sale of items to a person insured under Medicare Part A because, quote, such sales are considered exempt sales to the United States Government, end quote. Similar language is included in Regulation 1614(f). And this language first appeared in this forum in the 1980 amendments to 1614.

1591(f)(2)(A) goes on to state, quote, Under Part A the healthcare provider has a contract with the U.S. Government to provide certain services. Therefore, to the extent allowed pursuant to Regulation 1503, sales of medicines, devices, appliances, and supplies in which payment is made under Part A qualify as exempt sales to the United States Government, end quote.

In sum, Regulations 1591 and 1614 apply the exemption set forth in 63 -- in Section 6381 to sales of TPP to Medicare Part A patients which are considered to be sales to the U.S. Government, but for those provisions to apply, there must be a sale in the first place. Neither regulation proscribes any rules or requirements for when such a sale is made by a medical service facility. Certainly, neither states that all TPP furnished or used in the provision of services to a Part A patient constitutes a sale. Rather, as with all medical service facility transactions, when a sale is made to a Part A patient is determined by Regulation

1503.

In addition to being explicitly stated in Regulations 1503(b)(1) and 1591(f)(2)(A) this basic interplay between the three regulations is clearly described in Annotations 300.0130 dated November 25th, 1991, and the backup letter to Annotation 300.0007.200 dated April 30th, 1992.

As discussed in those annotations, an exempt sale to the U.S. Government only took place subject to the administered versus nonadministered provisions which had been in effect since 1970. Even under that rubric, furnishing administered TPP for a separately stated charge did not constitutes a sale.

The application of Regulation 1503 to Medicare Part A transactions was also discussed in the 2001 rulemaking documents for the amendments to Regulation 1503 the a title passage provision. Specifically, the July 26th, 2000, formal issue paper, Exhibit D, which states on page 4 that the Medicare Part A exemption would not apply when a medical service facility acts as a consumer, however, medical service facilities will still have the option to be a retailer by including an explicit clause in the contract between the facility and the patient transferring title to medical supplies items to the patient. In other words, the intent of the 2001

amendments was to replace the administered versus nonadministered provisions the title passage provision set forth in subdivision (b)(2)(C) with regard to Medicare Part A transactions.

So pursuant to Regulation 1503, Appellant is the consumer of the TPP it furnished to all patients unless one of the specific exceptions set forth in subdivision (b)(2)applies. Because Appellant's contracts did not contain title passage clauses to either the patient or the U.S. Government subdivision (b)(2)(C) does not apply. Therefore, under the express language of Regulations 1503, 1591, and 1614, Appellant was the consumer, not the retailer, of the TPP at issue. And for these reasons the appeal should be denied. Now I will turn to some of Appellant's arguments.

Appellants cites -- Appellant cites to one sentence from Annotation 505.0820. This annotation simply distinguishes between the two types of Medicare at that time: Part A, where there's a payment by the U.S. Government, and Part B, where there's reimbursement. This is the same distinction between Medicare Parts A and B recognized in Regulations 1591 and 1614, which effectively supercede this annotation.

As I have discussed, Appellant's interpretation is contrary to the plain language of these relevant

regulations and the actual administration of tax going back as far as 1970 when the administered versus nonadministered distinction was adopted. If anything, it was the promulgation of those rules in 1970 that signals an original intent with regard to Medicare Part A transactions.

Furthermore, Regulations 1614 and 1503 is -- are not in conflict as Appellant argues. 1614 relates to an exemption describing what type of sale is considered an exempt sale to the U.S. Government. And 1503 defines when such a sale occurs. Appellant's assertion that 1614 is more specific is essentially meaningless because the two regulations have entirely different effects.

Furthermore, Yamaha Corporation of America vs. State Board of Equalization does not state that a quasi -- quasi -- quasi-legislative regulation controls when interpreting two valid regulations, and Appellant has not offered any other authority for that proposition. Rather, for the purpose of judicial review of a particular regulation, Yamaha classifies types of regulations on a spectrum between quasi-legislative and interpretive for determining the standard of review a court should apply in assessing the validity of regulation.

We also note that Yamaha specifically discusses as quasi-legislative a regulation that, like 1503, determines when a sale occurs by requiring objective evidence of the transaction. Nor do we agree that a regulation applying a broad statute to a specific type of transaction as the relevant provisions of regulation 1591 and 1614 do here is necessarily quasi-legislative.

Appellant has also argued that the only relevant provision of 1503 to this case is (b)(2)(A) which states, that, quote, a medical service facility is the retailer of property furnished to persons other than residents and patients for a charge, end quote.

This argument has no basis in either the language of the regulation or its history. Subdivision (b)(2)(A) by its plain language is discussing transactions with persons who are not patients who might, for example, purchase nonprescription medicine, medical supplies, or other TPP at the hospital pharmacy.

There is nothing in the regulatory materials or, again, in the actual application of the law since 2001 to suggest that this provision applies to transactions involving patients at all. And given that this is the only scenario in which Appellant's theory would apply, Appellant is essentially asking us to consider it to be an unstated Medicare provision that

was intended to exempt all Medicare sales without actually mentioning Medicare and without any comment to that effect in the ruling-making file.

This is especially absurd given that the regulatory materials do specifically mention Medicare Part A with the respect to the subdivision (b)(2)(C) title passage provision, which leads us to Appellant's argument that by allowing title passage clauses to patients we are somehow finding patients to be federal instrumentalities.

Appellant is attempting to complicate the issue when the plain language of 1591 and 1614 is clear. 1591 and 1614 state that sales of TPP to Medicare Part A patients are considered exempt sales to the U.S. Government, not that they are sales to the U.S. Government. And by its own provision, 1591 directs us to 1503 to determine when such sales occur. Nowhere in these regulations or their histories does the word "instrumentalities" appear. The Department is bound to follow its own regulations. And as an administrative agency, OTA does not have authority to find the Department's validly promulgated regulations invalid. See Government Code Sections 11350(b) and 15672 as well as the cases Newco Leasing Incorporated vs. State Board of Equalization, 143 Cal.App. 3d 120 and Appeal of

Talavera. 2020-OTA-022P and Appeal of Micelle Laboratories, Incorporated, 2020-OTA-290P.

We also note that Appellant's various arguments are somewhat at odds with each other. On the one hand, Appellant argues that a sale to the patient cannot be considered a sale to the U.S. Government pursuant to the express language of Regulations 1591 and 1614, but Appellant also argues that despite there being no title passage clause between hospitals and the U.S. Government title must pass as a matter of law. Appellant apparently has no issue with there being a reasonable interpretation of this exemption. It just doesn't agree with the one expressly set forth in law and actually followed for decades.

In sum, because Appellant's contracts did not contain title passage clauses under the express language of Regulation 1503, Appellant was the consumer, not the retailer, of the TPP at issue. Therefore, Appellant is not entitled to a refund regardless of whether possession of the TPP transferred to the patient. However, as we've discussed in our January 21st, 2022 brief and Exhibit E, to the extent OTA considers whether possession of the specific items have transferred, we do not concede that possession transferred with every item Appellant put forward in Exhibit 4. And, in fact,

there's no evidence that possession transferred for those items.

And on a related note, despite our concession that Exhibits 9 through 16 are sufficient to establish that Appellant was charged and paid the tax or tax reimbursement in those seven transactions, we still cannot concede that there is any entitlement to the refund amount requested because the Department has not conducted a full refund examination, as we discussed in our briefs.

For the reasons I have outlined, we maintain that Appellant has not met its burden of proving that it is entitled to a refund for the tax or tax reimbursement it paid on its purchase and consumption of the TPP at issue and request that this appeal be denied. Thank you.

ALJ STANLEY: Thank you, Ms. Jacobs.

Judge Le, do you have any questions for the Department?

ALJ LE: Yes. One question.

What is the Department's position on whether 1614(f) is a quasi-Legislative reg or interpretive reg?

MR. CLAREMONT: As -- as Ms. Jacobs alluded to, it's a -- generally a quasi-legislative regulation is one where there's an express grant of quasi-legislative

authority. That doesn't appear to be the case here. It's a regulation that's interpreting a broad exemption for a specific set of facts. So although we don't think it's relevant for this matter because we think with all the regulations at issue are valid, we're not sure. As Yamaha discusses, it falls in a spectrum. It's not just one or the other. So we're not -- we don't really have a clear answer to where on that spectrum it falls.

ALJ LE: Okay. So it sounds like you're saying on that spectrum it falls closer to the interpretive side?

MR. CLAREMONT: Yeah. We believe it's an interpretive reg in that it is interpreting a broad exemption for a specific factual situation.

ALJ LE: Okay. Thank you. And same question for 1503.

MR. CLAREMONT: Again, I don't -- I don't know if -- again, we don't have necessarily a ranking on that spectrum. We do think it also falls within that spectrum. As Yamaha discusses with regard to another regulation that discusses when a sale takes place, Yamaha discusses that other regulation. And I don't have the specific regulation on point. It had to do with -- but it does have to do with when there's objective indication that a sale takes place and it was

discussing this quasi-legislative. But there's also interpretive elements, so we do think it also falls in that spectrum. But I don't think we have an answer necessarily, because we aren't a court, as to where exactly they fall relative to each other on that spectrum.

ALJ LE: Thank you.

No further questions.

ALJ STANLEY: Judge Kwee, do you have any questions?

ALJ KWEE: Yeah, I have a question for CDTFA.

So from your opening presentation, my understanding is CDTFA's position -- and following up on Judge Le's question -- is that OTA lacks jurisdiction to decline to follow a portion of 1503(b)(2)(C) regardless of whether it's interpretive or quasi-legislative. Is that a correct understanding of CDTFA's position?

MS. JACOBS: That's correct.

ALJ KWEE: Okay. Thank you. I also did want to get a little clarification on the 1503(b)(2)(A), (B), (C), (D). Is -- and I'm just wondering, so with Medicare Part A, would that only fall under, you know, like a (b)(2)(C) scenario or is it possible Medicare Part A could fall under 1503(b)(2)(A) or (b)(2)(B)? You know (b)(2)(A) was the medical service facility where

they're retail or furnishing property to persons other than residents. Could that even apply to Medicare Part A?

MR. CLAREMONT: Again, I -- I'm -- we're not experts in the scope of the actual administration of Medicare Part A. It appears that it would not -- (b)(2)(A) would not apply because, in our opinion, what (b)(2)(A) is simply saying is that before you get to patients and residents it's simply kind of an almost obvious rule that sales to non patients and nonresidents are retail sales, or furnishing to non patients and nonresidents outside of that the service of inpatient medical care. I do think (b)(2)(B) -- and I don't know, but (b)(2)(B) appears like it could apply because it could be a property that is furnished to a patient while they are receiving inpatient care but that there is an intention to take it outside the hospital. But, again, we are not experts in the scope of the Medicare programs.

ALJ KWEE: Okay. I was just trying to, I guess, clarify my understanding of the focus of the dispute was really centered on the title passage provision in (b)(2)(C) or if there was, I guess, a mix where Medicare Part A -- but I guess maybe that's not -- not too important to the issue. So thank you for the

clarification. I don't believe I have any further questions so I will turn it back to Judge Stanley.

ALJ STANLEY: Okay. I don't have any questions, so what we're going to do is go ahead and give Mr. Ferris the opportunity to respond and give -- have the final word.

MR. FERRIS: Thank you. I guess I would start by saying in terms of quasi-legislative regulations I -- I'm pretty familiar with the Sales and Lease Tax Regulations. I can't think of an example of a more bold and brash quasi-legislative move by the Board of Equalization than when they promulgated 1614(f) and said that, you know, this -- the Medicare Part A program that had been established, what, 23 years earlier, that that, once it became operative in 1966, that those were going to be considered to be direct sales, exempt sales to the federal government. That is very bold, very brash. That is uber gap-filling discretionary power of an enormous scale that they did to do that. It wasn't just a mere, oh, we're interpreting 6381. I mean it -- that was -- that was a true exercise of discretionary power to call out a new exemption that isn't expressly specifically, you know, prom -- enacted by the legislature. It is consistent with 6381, but the fact that they did that was very much a quasi-legislative

move.

And 1503 and 1591 are nowhere in that scale of boldness. They're just piggybacking. 1591(f)(2)(A) just piggybacking off of 1614(f) and 1503 until their 2021 amendments, had no reference to Part A at all. And I think it's very telling when they say that the way they read 1614(f) and 1591(f)(2)(A), I believe I heard the Department say that they are not sales to the federal government, they're just considered to be sales to the federal government but they're not sales to the federal government. And if they are not sales to the federal government, they can't be exempt because it's only exempt if they are direct sales to the federal government under 6381.

This is exactly proving our central point here. And the staff's thinking is still tainted by this idea that the focus on the patient can be the solution to how to operate the Part A exemption. It cannot. It has to be a direct sale to the federal government. It can't just be considered to be. If it's not actually a sale to the federal government, it can't be exempt.

So Appellant would like to close by emphasizing how important it is for the OTA to reach and rightly decide the legal issues in this case to avoid any possibility of getting bogged down in factual disputes

about burden of proof with respect to all the transactions related to the $27,213 refund amount at issue. In Exhibits 9 through 16, Appellant has documented the tax for tax reimbursement. It s charged by and paid to Appellant's vendors with respect to the seven exemplar transactions where actual or constructive possession of TPP was transferred to Part A patients.

Had this appeal followed a typical path, prior to reaching the OTA all of e transactions that comprise the $27,213 refund amount would have been validated as part of the appeals bureau process, but this has been kind of an unusual path we've been exclusively focused on the legal issues that are at issue. But it should be noted that the Department has never questioned whether Appellant routinely pays tax and tax reimbursements to its vendors for the medical supply items it purchases does not meet the definition of medicine, nor does the Department dispute that Appellant has a Part A contract with the federal government.

So, accordingly, if Appellant prevails on the legal merits of this appeal, Appellant believes it would be appropriate to grant the full requested refund in the amount of $27,213. However, if the OTA rules in Appellant's favor on the legal merits but would feel somehow constrained as to granting the full requested

refund amount, the tax amount at issue for the seven exemplar transactions, as previously stated and as substantiated in Exhibits 9 through 16, is $50.58.

The Department has conceded that the -- this amount of tax was charged and paid, and the substantiating documentation that's been provided is consistent with the type of documentation that the Department would be looking at if they were auditing this.

So I'm not -- I'm not sure what other additional things they need to see. Either they're a participating hospital under Part A and they paid tax -- they were charged tax and paid tax and then made exempt sales to the federal government and -- or they didn't. That's pretty much what needs to be looked at. There's not fixed assets, irrelevant, you know, trial -- everything else that they've listed in their laundry list or boilerplate of things that they would like to look at are not relevant to substantiating that $50.58 amount.

Now, as to reaching the legal merits, Appellant urges the OTA to provide further clarification with respect to the precedential Talavera opinion to make it clear that the OTA is fully committed to following the classification for regulations set forth by the

California Supreme Court in Yamaha. Talavera was correctly decided because the bad debt regulation at issue, Regulation 1642 in Talavera, that -- that regulation is clearly a quasi-legislative regulation. However, it would be very injurious to taxpayers if the logic of Talavera were applied to interpretive regulations like Regulation 1503(b)(2) and 1591(f)(2)(A).

The legislature created the OTA to be a level playing field for tax disputes where the controlling statutes would be applied in an impartial manner consistent with the rule of law. Upholding the Department's harmonization approach which mistakenly relies on irrelevant plain language found in interpretive regulation 1503(b)(2)(C) would be inconsistent with Section 6381.

Under Yamaha, it cannot be the case that any regulation the Department promulgates under Section 7051 is entitled to be treated with the dignity of a statute by the OTA. If the OTA were to disagree with Appellant's harmonization approach, the OTA must invalidate the application of Regulation 1503(b)(2)(C) with respect to Part A transactions.

Perhaps the biggest problem with the Department's improper harmonization approach is found in

Department's Exhibit F. In the 2019 issue paper, the Department proposed the adoption of subparagraph (b)(2)(D), which, starting in 2019, requires both title and possession of TPP to transfer to Part A patients to operate the Part A exemption. The issue paper is clear. The Department proposed this rule because the Department does not believe the title passage clauses between participating medical service facilities and Part A patients have any real substance.

Accordingly, the Department's proposed harmonization approach with respect to subparagraph (b)(2)(C) lacks a rational basis for the tax treatment distinction that results between medical services facilities that have title passage clauses with Part A patients for periods prior to January 1st, 2019, and those that don't, like Appellant.

Classifications that have no rational basis result in a legal discrimination and are invalid. This is true whether the discriminatory tax classification is created by a statute or by a regulation or by an erroneous interpretation of a statute or regulation.

As discussed in more detail in Appellant's briefs, while the OTA does not have the authority to invalidate a discriminatory statute or a quasi-legislative regulation, the OTA does have the

authority and the responsibility to interpret statutes and regulations in a manner that avoids discriminatory effect and preserves validity. In short, as the California Supreme Court held in Hughes v. Board of Architectural Examiners, the OTA is obligated to avoid interpretations that would lead to invalidation in the courts.

The law establishing that the Department's subparagraph (b)(2)(C) harmonization approach would lead to invalidation by the courts is clear. In Maranville v. State Board of Equalization, the California Court of Appeal held that, quote, Section 1 of the 14th Amendment to the Constitution of the United States applies to state and local tax statutes. While the State may classify broadly the subjects of taxation, it must do so on a rational basis so that all persons similarly circumstanced will be treated alike. Rules of the agency empowered to enforce a tax which result in illegal discrimination are invalid, end quote.

Under Yamaha, no reasonable California court would defer to the Department taking the position that title passage clauses with Part A patients have substance, albeit unconstitutional discriminatory substance, through December 31st of 2018 but then lose their substance on January 1st, 2019. The OTA must also

decline to extend such deference to the Department.

To be clear, Appellant is not asking the OTA to rule on the constitutionality of a statute or a quasi-legislative regulation. Appellant is merely asking the OTA to observe its duty to reject erroneous interpretations of the governing statute that would create unnecessary constitutional infirmities, which is what would occur if the OTA were to bless the Department's subparagraph (b)(2)(C) harmonization approach.

In short, the existence or nonexistence of title passage clauses between participating medical service facilities and Part A patients cannot be the determining factor for when the Part A exemption operates and when it does not.

In conclusion, pursuant to Section 6381 and quasi-legislative Regulation 1614(f), Part A patients cannot be treated as federal instrumentalities. Accordingly, medical service facilities cannot lose the benefits of the Part A exemption because they do not have title passage clauses with their Part A patients to create direct sales of TPP to Part A patients.

To be faithful to its calling established by the legislature, the OTA cannot defer to the administrative error committed by the Department staff

in 2001 when it first suggested the solution of using patient title passage clauses to operate the Part A exemption. Regulation 1503b)(2)(C) is either irrelevant through the operation of the Part A exemption or it is invalid to the extent it is applied to Part A transactions.

The OTA was not created to follow or defer to interpretive recipes created by the Department decades ago that contradict the controlling statutory law. It's time to reject the Department's harmonization recipe and put the whole pot roast in the oven. Accordingly, Appellant respectfully asks the OTA to reverse the Department's action in this matter. Thank you.

ALJ STANLEY: Thank you, Mr. Ferris.

Judge Le, do you have any questions?

ALJ LE: No further questions. Thank you.

ALJ STANLEY: And, Judge Kwee, do you have any follow-up questions?

ALJ KWEE: I have no final questions. Thank you.

ALJ STANLEY: I'm just going to ask the Department to clarify the one piece that was -- that was raised in the closing statement about the seven transactions totaling $50.58. In the Department's response to Exhibits 9 through 16, while they agreed,

they did say that as part of a refund examination, the Department generally obtains confirmation from the purchaser that it had not already received a refund of the tax or tax reimbursement from the seller.

Is the Department proposing that if the OTA grants that refund, it would be conditional on the Department doing some follow-up?

MR. PARKER: Generally speaking, we would look into whether the vendors were audited and whether similar transactions were refunded to a vendor. If we're only talking about the -- the limited transactions that we have here, we'd probably feel pretty comfortable in granting the $50 refund for those seven transactions.

ALJ STANLEY: Okay. Thank you.

Okay. This -- this concludes the hearing and the record is now closed and the matter is submitted for deliberation. The panel will meet to jointly deliberate and decide the appeal, and we will issue a written opinion no later than a hundred days from today.

I want to thank you all for your participation. And we are going to reconvene at 1:00 p.m. today.

Thank you.

(Conclusion of the proceedings at 10:55 a.m.)

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REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)
COUNTY OF SACRAMENTO) ss.

I, MARIA ESQUIVEL-PARKINSON, do hereby certify that I am a Certified Shorthand Reporter, and that at the times and places shown I recorded verbatim in shorthand writing all the proceedings in the following described action completely and correctly to the best of my ability:

LOCATION: OFFICE OF TAX APPEALS
400 R Street

CASE: In the Matter of the Appeal of Redwood Memorial Hospital, Inc.

DATE: Tuesday, January 24, 2023

I further certify that my said shorthand notes have been transcribed into typewriting, and that the foregoing pages 1 through 60 constitute an accurate and complete transcript of all my shorthand writing for the dates and matter specified.

I further certify that I have complied with CCP 237(a)(2) in that all personal juror identifying information has been redacted if applicable.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California on this 10th day of February, 2023.

Maria Esquivel-Parkinson
CSR No. 10621, RPR

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