

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,)
)
SPECIALIZED ORTHOPEDIC SOLUTIONS, INC.,) OTA NO. 18042986
)
APPELLANT.)
)
)
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TRANSCRIPT OF PROCEEDINGS

Cerritos, California

Thursday, September 14, 2023

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Proceedings, taken at
12900 Park Plaza Dr., Cerritos, California, 91401,
commencing at 11:37 p.m. and concluding
at 3:39 p.m. on Thursday, September 14, 2023,
reported by Ernalyn M. Alonzo, Hearing Reporter,
in and for the State of California.

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APPEARANCES:

Panel Lead: ALJ JOSHUA ALDRICH

Panel Members: ALJ MICHAEL GEARY
ALJ RICHARD TAY

For the Appellant: MARCUS FRISHMAN
MARK CUMMINS

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

AMANDA JACOBS
CHAD BACCHUS
RANDY SUAZO

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I N D E X

E X H I B I T S

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1 Cerritos, California; Thursday, September 14, 2023

2 1:37 p.m.

3
4 JUDGE ALDRICH: This is Judge Aldrich. We're
5 opening the record in the Appeal of Specialized Orthopedic
6 Solutions Incorporated before the Office of Tax Appeals,
7 OTA Case No. 18042986. Today's date is Thursday,
8 September 14th, 2023, and it's approximately 1:30 in the
9 afternoon. This hearing is being conducted in Cerritos,
10 California, and is also being live streamed on OTA's
11 YouTube channel.

12 The hearing is being heard by a panel of
13 Administrative Law Judge. My name is Josh Aldrich. I'm
14 the lead Administrative Law Judge for purposes of
15 conducting the hearing. I'm joined by Judges Richard Tay
16 and Michael Geary. We three are coequal decision makers.
17 As such, during the hearing, panel members may ask
18 questions or otherwise participate to ensure that we have
19 all the information required. After the conclusion of the
20 hearing, we three will deliberate and decide the issue
21 presented.

22 As a reminder, the Office of Tax Appeals is not a
23 court. It is an independent appeals body. The panel does
24 not engage in ex parte communications, meaning we don't
25 speak with one party or the other party when that party is

1 not present. Our opinion will be based on the parties'
2 arguments, the admitted evidence, and the relevant law.
3 We have read the parties' submission, and we look forward
4 to hearing your oral arguments today.

5 Who is present for the Appellant.

6 MR. CUMMINS: Mark Cummins.

7 JUDGE ALDRICH: Thank you.

8 MR. FRISHMAN: Marcus Allen Frishman.

9 JUDGE ALDRICH: All right. And I believe we also
10 have Mr. VonderHaar.

11 MR. VONDERHAAR: I'm Jeffrey VonderHaar.

12 JUDGE ALDRICH: Thank you. And for the --

13 MR. FRISHMAN: Who is the taxpayer.

14 JUDGE ALDRICH: Thank you.

15 And for Respondent or CDTFA, also known as the
16 California Department of Tax and Fee Administration?

17 MS. JACOBS: Amanda Jacobs, Tax Counsel.

18 MR. BACCHUS: Chad Bacchus, Attorney IV, with the
19 Department's legal division.

20 MR. SAMARAWICKREMA: Nalan Samarawickrema,
21 Hearing Representative for the Department.

22 JUDGE ALDRICH: Thank you.

23 So based on a scheduling conflict, OTA made a
24 substitution to the panel. And initially there was an
25 August 30th, 2023, notice that was revising the panel, and

1 subsequently there's another panel revision substituting
2 in Judge Geary.

3 Mr. Frishman, any objection to Judge Geary?

4 MR. FRISHMAN: I have none.

5 JUDGE ALDRICH: Okay. And Ms. Jacobs?

6 MS. JACOBS: None. Thank you.

7 JUDGE ALDRICH: Okay. Thank you.

8 So for CDTFA, there's three of you up there. Who
9 will be presenting the argument?

10 MS. JACOBS: I will.

11 JUDGE ALDRICH: Thank you.

12 And similar question, Mr. Frishman, Mr. Cummins,
13 there's one appeal, but there's two represents, and I want
14 to make sure that the record is clear. So have you
15 decided how you're going to divide the workload today?

16 MR. FRISHMAN: Yes, we have. I'll be making an
17 opening statement, and CPA Cummins will get into more of
18 the details and questions.

19 JUDGE ALDRICH: Okay. So great.

20 The issue to be decided is whether Appellant has
21 shown that adjustments are warranted to the audited
22 taxable measure, which was distributed according to our
23 July 11th, 2023, minutes and orders.

24 Is that correct statement, Mr. Frishman?

25 MR. FRISHMAN: Fair enough.

1 JUDGE ALDRICH: Okay. Ms. Jacobs?

2 MS. JACOBS: Yes.

3 JUDGE ALDRICH: All right. So regarding
4 exhibits, CDTFA's exhibits were submitted as -- or marked
5 as Exhibits A through G. OTA distributed a copy of these
6 exhibits. They were hyperlinked to the July 11th, 2023,
7 Minutes and Orders.

8 So, Mr. Frishman, do you have any objection to
9 admitting CDTFA's Exhibits A through G?

10 MR. FRISHMAN: I do not.

11 JUDGE ALDRICH: Okay. So similarly for
12 Appellant, on August 3rd, 2023, Appellant submitted an
13 additional brief, which was later identified as Exhibit 1.
14 Also, Appellant indicated that it would be bringing
15 various devices to the oral hearing as Exhibit 2. And I
16 see that those were marked Exhibit-1, Exhibit 2-1, Exhibit
17 2-2, et cetera, for identification purposes. Also,
18 Appellant submitted Exhibits 3 and 4 on August 31st, 2023.
19 As a courtesy, the Office of Tax Appeals combined the
20 documentary exhibits and distributed them to the parties
21 in a hearing binder. There was subsequently a revision
22 based off of an error.

23 Mr. Frishman, did you receive a copy of that
24 binder?

25 MR. FRISHMAN: We received no binder.

1 JUDGE ALDRICH: Okay. Just so you're aware that
2 they are the same exhibits that were attached to the
3 Minutes and Orders, or they are the ones that you
4 submitted.

5 MR. FRISHMAN: Gotcha.

6 JUDGE ALDRICH: And, CDTFA, did you receive a
7 copy of the binder?

8 MS. JACOBS: We received the PDF, yes.

9 JUDGE ALDRICH: Okay. So the deadline to submit
10 additional exhibits was August 31st, 2023, but I see here
11 that there was possibly additional submission?

12 MR. FRISHMAN: Yes.

13 JUDGE ALDRICH: Okay. First, for CDTFA, any
14 objection to the additional submission?

15 MS. JACOBS: Are we talking about the
16 prescription that you passed out today?

17 JUDGE ALDRICH: So it's marked Exhibit 2-12.

18 MS. JACOBS: Yeah. We don't have any objections.

19 JUDGE ALDRICH: Okay. And, Mr. Frishman, can you
20 give me an offer of proof or why -- what are you trying to
21 show with this exhibit?

22 MR. FRISHMAN: I'll let Mark Cummins answer that
23 question.

24 JUDGE ALDRICH: Okay.

25 MR. CUMMINS: It goes into -- we're discussing

1 the reason that this particular unit is being prescribed.
2 And I think looking at the actual doctor's orders, since I
3 have the unit here, very useful.

4 JUDGE ALDRICH: Okay. And perhaps I'm incorrect,
5 but was there a dispute as to whether or not the
6 disallowed claimed medical devices were prescribed?

7 MR. FRISHMAN: No.

8 MS. JACOBS: No, we don't dispute that.

9 JUDGE ALDRICH: Okay. And so, Mr. Cummins, it's
10 more for the nature as to why they were prescribed?

11 MR. CUMMINGS: Yes, why they were prescribed, and
12 why the nature of, if they are prescribed for one way it's
13 taxable, and if they are prescribed another way, it's
14 nontaxable.

15 MR. FRISHMAN: Comparisons.

16 MR. CUMMINGS: Comparisons.

17 JUDGE ALDRICH: Okay. Understood.

18 All right. Which leaves the physical devices
19 that we have present here. So with respect to the
20 physical devices, I'm not inclined to admit them into the
21 record because it would present a storage issue. Instead,
22 I have a proposition for you that we incorporate the
23 digital copy. So as you know there are cameras present.
24 And Appellant is welcome to manipulate the devices during
25 testimony or describe them, and I can zoom in the

1 taxpayer's table.

2 And as an example, I'm going to ask Judge Tay to
3 press the zoom button.

4 So that would give you the view of those devices.

5 MR. FRISHMAN: Sure. Make sense.

6 JUDGE ALDRICH: And it's a little bit closer up.
7 That way it's easier for us to reference.

8 MR. FRISHMAN: That's fine.

9 MR. CUMMINS: We don't need fine detail on this.
10 It's mainly going to be what they are in the story.
11 That's why I brought them.

12 JUDGE ALDRICH: Okay.

13 MR. FRISHMAN: That's fine.

14 JUDGE ALDRICH: So like I said, I'm inclined to
15 admit the digital copy of them but not the actual physical
16 item.

17 MR. FRISHMAN: We don't want to give them to you.

18 JUDGE ALDRICH: Fair enough.

19 MR. FRISHMAN: He has to return it later to get
20 his money back.

21 MR. CUMMINGS: I got a good tax write off.

22 JUDGE ALDRICH: All right. So, CDTFA, do you
23 have objection to the other exhibits discussed, so
24 Exhibit 1, 2, 3, and 4? And then you already addressed
25 the additional submission today.

1 MS. JACOBS: No objections. Thank you.

2 JUDGE ALDRICH: All right. So there are no
3 objections to either parties' exhibits. They're all
4 admitted into the record, except as to the physical
5 devices, and a digital copy will be admitted. Okay.

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

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

10 MR. FRISHMAN: All right.

11 JUDGE ALDRICH: All right. So this is to give
12 everyone a reminder or overview of how the hearing will
13 proceed from here on out. We allotted 75 minutes for
14 Appellant to provide an opening presentation and witness
15 testimony, followed by a combined presentation from CDTFA,
16 which we allotted 25 minutes for. We allotted 5 to
17 10 minutes for questions from the panel, and then we'll
18 follow or end it with closing remarks or rebuttal from
19 Appellant. Okay?

20 MR. FRISHMAN: That's fine.

21 JUDGE ALDRICH: Great. So with respect to
22 witness testimony, Mr. VonderHaar, I'd like to go ahead
23 and swear you in. That way when it's time for witness
24 testimony it's already covered. Okay?

25 MR. VONDERHAAR: Absolutely.

1 JUDGE ALDRICH: If you could just raise your
2 right hand.

3

4 J. VONDERHAAR,

5 produced as a witness, and having been first duly sworn by
6 the Administrative Law Judge, was examined, and testified
7 as follows:

8

9 JUDGE ALDRICH: Thank you.

10 MR. FRISHMAN: Question?

11 JUDGE ALDRICH: Yes.

12 MR. FRISHMAN: Why aren't we sworn in?

13 JUDGE ALDRICH: You're giving argument. You're
14 not giving evidence or testimony. Similarly, CDTFA is
15 providing argument, and they are relying on things in
16 evidence to make that argument.

17 Okay. So I believe we're ready to proceed with
18 Appellant's opening.

19 MR. FRISHMAN: Okay. I'm going to begin with a
20 short opening -- short relative to the 75 minutes we
21 have -- a short opening statement.

22

23 OPENING STATEMENT

24 MR. FRISHMAN: First, I'll introduce myself. I
25 was 1 of 14 Constitutional officers here in California. I

1 was the appointed tax official, former Chief Deputy Board
2 Member of the Board of Equalization and there three-member
3 Franchise Tax Board. I now run the MAF Group, a team of
4 attorneys, CPAs, and lobbyists. We help people get out of
5 trouble.

6 Please pardon me, Judges. I'm going to be
7 referring to my notes very closely to enhance the accuracy
8 of my comments. So I'll essentially be reading.

9 This is the start of our oral argument, which I
10 code named, "Schrodingers Cat" for internal reasons. You
11 can look it up later.

12 THE STENOGRAPHER: I'm sorry to interrupt. What
13 kind of cat?

14 MR. FRISHMAN: Oh, I'll spell it for you.
15 S-c-h-r-o-d-i-n-g-e-r-s Cat.

16 I won't be explaining why.

17 This is the start of our oral presentation. I
18 want to begin by thanking you. We've asked for three
19 hours on our side, and you gave us 75 minutes. We hope
20 that will be enough.

21 We begin with two matters, an objection and a
22 point of note. Because of the high tax liability of this
23 tax --

24 JUDGE ALDRICH: Mr. Frishman.

25 MR. FRISHMAN: Yes.

1 JUDGE ALDRICH: I'm sorry to interrupt. But
2 could you slow it down just a little bit.

3 MR. FRISHMAN: Yes. Remind too. Thank you.

4 Because of the high tax liability of this matter,
5 and the fact that it may end up in civil court and put our
6 client out of business, we'd like to enter with an
7 objection for the record.

8 We asked for subpoena of the auditor who still
9 works for the CDTFA. The CDTFA objected, and the
10 objection was upheld by this judge panel. This is
11 tantamount to the traffic cop not showing up to court,
12 except we don't automatically win.

13 Your Honors, if we can't cross-examine the person
14 making all the statements in the audit and the audit work
15 papers, you have created an unbalanced and an unfair
16 proceeding. This is said with all due respect to you.
17 There is now only one person here -- pardon me. There is
18 now only no one here on the CDTFA's side that can make any
19 statement of facts actually contemporaneous to the
20 procedures or what occurred in the audit. The only person
21 that can do that today is our client, Jeff. Thus, this
22 panel has self-created a potential hearsay component of
23 this argument.

24 It did not have to be that way. The essence of
25 the effect of defense requires the ability to

1 cross-examine witnesses. If you eliminate the ability to
2 cross-examine, you have greatly hampered our effective
3 representation. So we would request, as a result of this
4 objection, we would ask you for a ruling on our objection
5 at any time you deem it appropriate during this day.

6 Moving on to our point of consideration, a point
7 of note. The CDTFA has refused to respond to our
8 submitted brief. I'm a member of this proceeding, and I
9 find it disrespectful to the California taxpayers and this
10 proceeding for them to be silent on our submitted brief.
11 They have a right to do that I realize. They're
12 nonresponse may be indicative of wanting to ignore the
13 truth and real facts. They have relied only on old
14 documents, not expecting the proceeding today as a trial
15 de novo, a trial on the entirely new case where both
16 questions of law and issue of law are determined as if
17 there had been no previous hearings.

18 Yet, the CDTFA submitted nothing new. On the
19 other hand, we have updated and revised our argument. Our
20 original argument may have had some reasoning that kept
21 our argument from delivering the degree of facts that
22 facilitates the correct conclusion we seek today. Because
23 of this deficit, we have started over. We now have a new
24 degree of facts that we believe will deliver expected
25 results. The CDTFA did not do that.

1 The only question we believe is present today
2 that needs to be answered is are pneumatic compression
3 units exempt from taxation as medicines as defined by the
4 law. Medicines. The case is a conundrum. The case of
5 SOS Medical is that of a conundrum and some-what of a
6 paradox in a manner of speaking. Today's quandary will be
7 sorted out by investigation of the facts. If you read the
8 old CDTFA doc -- submitted writings, the old documents
9 that they submitted, they rely heavily on errored
10 information provided by the taxpayer, client, before we
11 represented him.

12 The taxpayer provided written marketing material
13 that was factorially flawed. They're calling it
14 Exhibit 6. As a former chief deputy Board member of the
15 agency, I know for a fact that when the agency -- pardon
16 me -- I know for a fact that when the agency can exploit
17 your errors, they do it on steroids and they will probably
18 tax those steroids. But the truth and empirical facts are
19 all that matter in the end.

20 We presented the truth -- I'm sorry. Pardon me.

21 When presented the truth, the agency negates the
22 tax. They will ignore it. If you give them mistaken
23 information that creates a new tax, they will embrace it.
24 If you show them true facts that prevent the creation of a
25 new tax, they will fight it. That's how they are. There

1 was a similar case, a very notable case, that I
2 highlighted in our brief that we submitted to you before
3 this hearing.

4 I remember the staff position on this health care
5 product, and it was conceptually identical to this case.
6 That's why I bring it up in very brief point. The staff
7 said that product box said X, meaning X creates a tax.
8 They took it up on appeal to the five-member Board
9 Equalization. And the staff lost, because the five-member
10 Board did not care what the claims on the box were. They
11 cared what the truth of the product was. Not how the
12 product was held out in public marketing material.

13 The Board agreed that the marketing material, if
14 true, did create a new tax. But at the hearing, they
15 found it was not true and voted to cancel this new tax.
16 The case was famously called the "Medicinal California Tea
17 Tax." The CDTFA cannot have it both ways. Only the truth
18 matters. Today we make an attempt to show the truth about
19 this item, the medical units in question. Revenue &
20 Taxation Code 639, we conceded excludes -- we have
21 conceded excludes certain devices definitions of
22 medicines.

23 Our items are not a device as defined by this
24 section in question and, therefore, are not excluded.
25 This is not an orthopedic device as listed in that

1 section. This issue is to be decided by medicine and the
2 law -- the tax laws related to medicine. There are some
3 facts the CDTFA, according to the final appeal, the final
4 words from the CDTFA in their submission as a matter of
5 record, was issued by tax counsel Dang Nguyen -- Nguyen
6 Dang, March 20, 2018. And it's actually the last document
7 written by the Board of Equalization on this matter before
8 it was transferred to the new agency.

9 One, a doctor's prescription order is required
10 for the sale of this item. They agree with that. It's
11 not legally on the retail sales market. They agreed with
12 that in writing. It provides subcutaneous medical care
13 treatment. They agreed with that. It's new medicine and
14 falls within a highly specialized branch of medicine.
15 They agreed. The units are indeed used for medical
16 treatment and disease. That one they double downed on.
17 They agree. They said so here today, in fact, if you
18 listen closely.

19 Furthermore, it's not a debate on whether this is
20 an orthopedic device. This is not a debate of whether
21 this is a tangible personal property for sale or lease.
22 This is a debate of whether the item is a medical service
23 or treatment. My client's company, SOS Medical, is very
24 much like a pharmacy. The CDTFA record, as I stated
25 earlier, they did not submit anything new on these

1 concepts.

2 So I can only respond to what they did submit.
3 Both of us together can only respond to that stuff. All
4 the old case audit papers and decision documents
5 therefore, if we look at them today and start off this
6 appeal, we actually have a narrow focus of disagreement
7 with the agencies. I do not think they have read their
8 own position of record closely. On the CDTFA's last
9 formal written decision dated March 16, 2018, Tax Counsel
10 Nguyen Dang opines on several topics that are no longer in
11 question or in dispute by us or them today.

12 Tax Counsel Dang focuses only on the remaining
13 issues on the last page of his March 16th statement, the
14 last paragraph. That's all that's in dispute today. The
15 item, is it medical treatment or not? There is no other
16 issue to date to talk about or discuss, according to the
17 CDTFA, not me. Not us.

18 Judges, you have to put out of your head the
19 understanding -- the common and general understanding of
20 medicine and look at the tax law on medicine closely, and
21 to establish good public policy decisions, we in alignment
22 with that current law. We believe and support that
23 current law. You must instead, rely closely on the words
24 of the law, and you have to think broadly about them. In
25 support of our contention that the units are medical as

1 defined by law, we reference the same law that Tax Counsel
2 Dang referenced on the last page of his March 16th, 2008,
3 supplemental decision.

4 Tax Counsel Dang agreed with our contention that
5 the item in question was prescribed by -- was a prescribed
6 medicine for treatment of a disease. Dang wrote the
7 CDTFa, quote, "While we repeatedly" -- sorry.

8 Dang wrote, quote, "While we readily accept that
9 the pneumatic compression and heat and cold therapy units
10 at issue are prescribed by a licensed physician in order
11 to prevent or treat disease." So he's conceded that
12 significant point.

13 But he goes on, quote, "The evidence establishes
14 that these items are not similar in form to preparations
15 or similar substances." That's where he's wrong. That's
16 the question.

17 Regulation 1591 subdivision (a), (9), and (b),
18 which states, "Medicines means any substance or
19 preparation intended for the use by external or internal
20 application to the human body in the diagnoses, cure,
21 mitigation, treatment, or prevention of disease, and which
22 is commonly recognized as a substance or preparation
23 intended for use." Those are two important words,
24 substance or preparation. I'm reading it from the law.

25 And so we're clear, preparation is an item. It's

1 a unit. Preparation is an item. It's a unit ready for
2 the use for a particular purpose. Dang uses the word item
3 and unit interchangeably to describe our client's
4 product -- our client's item, unit. Our contention is
5 that the sales and leases of pneumatic compression units
6 are qualified as exempt sales of medicine because the
7 items are used or treated to prevent disease and can only
8 be obtained by a physician prescription as Counsel Dang
9 agreed.

10 So we are in alignment with CDTFA's official
11 position up to the point of the similarity issue. We only
12 differ with CDTFA on this similarity component. That's
13 what we have to resolve today. We have never commented on
14 the similarity issue until this hearing because we have
15 not had an opportunity to do so. Let's fine tune this
16 minor dispute with the CDTFA at this point. Revenue &
17 Taxation Code 6369 subdivision (b) Regulation 5991
18 subdivision (a), (9), and (b), define a medicine in
19 relevant part as a similar preparation -- similar
20 preparation is a key -- or substance intended for use by
21 external or internal application to the human body in
22 diagnoses, cure, mitigation, treatment, or prevention of
23 disease -- I've read it twice. I know. -- and which is
24 commonly recognized as a substance or preparation intended
25 for such use.

1 Take note the word preparation is an item or a
2 unit and it is not a redundancy to the next word,
3 substance. The word preparation is used to describe many
4 things, including manufactured medical items or units.
5 While the word substance is used to describe things like
6 ointments and other -- other similar -- because we
7 maintain we're also similar to ointments. We think we get
8 it both ways in medical use treatments and results in
9 disease care. Our units are like that also.

10 According to vocabulary.com -- a pretty good
11 source, but you can find it anywhere. And have that right
12 here. According to vocabulary.com, when look up this word
13 "preparation," what comes up is something very clear. The
14 item that must be produced to achieve a purpose. An item
15 that must be produced to achieve a purpose, a unit, a
16 machine, a manufactured item. There it is. It's on the
17 internet, but you can look and find it everywhere. It's
18 repetitive. It's a definition.

19 Thus, for the sale of medicines like ours to be
20 exempt under Section 6369 and Regulation 1591, not only
21 does it have to be -- not only does the preparation in
22 question need to use or treat and prevent disease like
23 Attorney Dang at the CDTFa tells us, it must also be
24 similar in form to other preparations or other substances
25 and be commonly recognized as preparations intended for

1 that use. Those are CDTFA counsel words. We agree. It
2 should be.

3 Commonly recognized by who, though? Well, we say
4 commonly recognized by medical professionals, not the
5 junior tax auditor that we're not able to question today.
6 So it takes some work. It's hard to do, and that's why
7 we're here.

8 Your Honors, do you want to agree with CDTFA that
9 this item belongs in the tax category of tangible personal
10 property. That's where they say it should be after the
11 Board itself admits it is medicine, as defined by the tax
12 law -- which is a quandary in itself -- but somehow is
13 disqualified as tax exempt by the agency's mistaken belief
14 that it's not similar to other medicines or preparations
15 as judged by the auditor.

16 In California, medical goods and services are
17 generally all tax exempt. Please don't move down this
18 category of tangible personal property and tax it. I
19 believe it is so important to have good public policy that
20 includes equity and fairness. How fair or how equitable
21 would it be to tax this medical item? It's a rhetorical
22 question. We'll answer in a few minutes. The people need
23 this. These people are suffering. Many of them are
24 seniors. They're financially hardshipped, and we
25 shouldn't be putting this into the category of furniture

1 and other clear tangible personal property that you buy
2 and are charged sales tax for.

3 I'd like to take the opportunity now to turn it
4 over to my partner Mark Cummings. Mark works with me as a
5 collaborative professional as part of my MAF Group. He
6 runs his own independent consulting firm as a CPA outside
7 of my MAF Group, and he's quite a scholar. He's an
8 Ernst & Young former associate. He has a claim to fame.
9 I'll end with this, he discovered the Countrywide home
10 loan scandal all by himself as a lead auditor there. It
11 was pretty significant. He's -- he's bashful.

12 MR. CUMMINGS: Yes. A bit of a hyperbole.

13 MR. FRISHMAN: Well, it's not a hyperbole. You
14 deserve the credit. Now it's a matter of record. Now
15 everybody who is watching -- all 12 of them there -- they
16 know it. So Mark Cummings, CPA.

17 MR. CUMMINGS: I'm sorry, but can I take a quick
18 break to use the men's room?

19 JUDGE ALDRICH: Absolutely. So we'll do a
20 10-minute break and return at 2:15.

21 MR. CUMMINGS: Great thank you.

22 JUDGE ALDRICH: And we'll go off the record until
23 that time. Thank you.

24 (There is a pause in the proceedings.)

25 JUDGE ALDRICH: Thank you. Yes, we're going back

1 on the record.

2 So there's approximately 55 minutes left of the
3 75 minutes.

4 MR. CUMMINGS: Okay. Very good.

5 JUDGE ALDRICH: And is Mr. VonderHaar's
6 microphone on?

7 MR. VONDERHAAR: Testing. Yes, it is.

8 JUDGE ALDRICH: Can you bring it just a little
9 closer to you?

10 MR. VONDERHAAR: Of course. How is that?

11 JUDGE ALDRICH: All right. Please proceed.

12

13 PRESENTATION

14 MR. CUMMINGS: Okay. Before I have questions for
15 Mr. VonderHaar I have some opening statements.

16 First of all, I have a bump on my face. Two
17 reasons I'm bringing it up. One is that you guys won't be
18 wondering what the hell is on that guy's face. It's not
19 contagious. I live in Topanga. It has a lot of critters
20 there, spiders, mosquitos, and so on. I got bit by a
21 spider five days ago and got infected. So what I do? I
22 went to the doctor, and the doctor gave me two
23 prescriptions. And it was interesting because I'm, you
24 know, preparing for this case. And one is an ointment,
25 which I'll -- we'll talk about that a little later.

1 This is another prescription ointment but not the
2 one that I'm using. I didn't want to lose it here. And
3 so I was had highly interested in would it be taxable or
4 not? I surmised it would not be. It would not be. So I
5 went to CVS and got the receipt. And it was funny because
6 I was thinking I'm usually not this interested in receipts
7 even though I am an accountant, but I was very interested
8 in it. And sure enough both of these items were
9 nontaxable.

10 Let me give you some background on sales tax
11 audit from my experience. If I'm speaking -- if you guys
12 are more experienced and I'm speaking a little down to
13 you, I want to apologize ahead of time. But I want to
14 tell you what this audit is not. This is not an audit
15 where a client is understating income. Well, what does
16 that mean? Well, I've seen it all: Cash transactions are
17 not reported; sales don't agree to the bank statements or
18 the tax returns; sales are reported in another company;
19 sales put in personal accounts; audits are often cat and
20 mouse games.

21 Marcus and I typically do not take clients that
22 are clearly hiding income. It's not good for our license,
23 and they are hard to defend. We just don't like it. But
24 the CDTFA does try to prove a client's sales. And hence,
25 sales tax, they think in many cases should be higher, and

1 they go to great lengths to prove it.

2 I'll give you examples. They'll do calculations
3 on the number of pours of drinks sold in a bar in a
4 certain month. So in other words, a bottle of tequila
5 typically with a normal pour is 20 shots. Ten bucks a
6 shot, that's 200 bucks. So they'll do the math, and
7 they'll go through all of the purchases and sales of that,
8 and they'll do the multiplication and sometimes they're
9 twice as much as the client. Well, this particular client
10 we did had a heavy pour. They did two shots for one pour.
11 So there were only ten pours in a bottle for one-hundred
12 bucks.

13 So if they're doing this sort of metric
14 calculation type of thing, it doesn't -- it doesn't equate
15 to what the reality is in this particular case. We had a
16 restaurant in -- I forgot that town here, down here in
17 Orange County that was a Vietnamese restaurant that
18 primarily sold soup. And they went through a similar
19 calculation with the amount of meat that was sold. And
20 what was interesting is that 50 percent of the meat
21 purchased was bone and another 25 percent was fat. So the
22 only amount of meat that was typically used in a bowl of
23 soup was, like, 25 percent of it.

24 So they said their sales were X. CDTFA went
25 through BOE at the time, went through and said oh, no.

1 You should have, like, \$2 million, I think, was the
2 number. And what was interesting about that number is
3 that had every person in that little town -- there was
4 about 10,000 -- had soup everyday, five days a week, it
5 would not equal that number.

6 I don't even want to talk about two sets of books
7 that I see people do. That's not what this is. What is
8 this also not? This is not a taxpayer that collected the
9 sales tax and didn't remit it to the CDTFA. Marcus and I
10 represented a French bistro who bought it from other folks
11 and didn't realize that there was a lot of goodwill and
12 the people went to this restaurant because of this lovely
13 couple that ran it. And, unfortunately, sales dropped by;
14 like, 30 percent.

15 He had trouble paying help. He had trouble
16 paying the rent. He charged sales tax. He charged the
17 right amount. He reported it. He didn't want to fool
18 around with it, but he couldn't remit it to the CDTFA, or
19 he would go out of business. And there was a lot of
20 really -- he had a very hard time. What happened? Well,
21 the business closed down. That is still sitting out
22 there. He is now a bartender in Utah or some other place
23 right now and the money hasn't been spent.

24 But this is not what this is. Or there are
25 clients that keep the money.

1 JUDGE ALDRICH: Mr. Cummins, I'm sorry to
2 interject, but instead of focusing on what it is not,
3 perhaps you could focus on what this audit is.

4 MR. CUMMINGS: I'm almost there.

5 JUDGE ALDRICH: Okay. My understanding is that
6 it was based off of -- there wasn't any dispute as to --

7 MR. CUMMINGS: No.

8 JUDGE ALDRICH: -- whether or not the sales
9 occurred.

10 MR. CUMMINGS: Right.

11 JUDGE ALDRICH: It's just tax was not collected,
12 and they were disallowed as exempt.

13 MR. CUMMINGS: Exactly.

14 JUDGE ALDRICH: Okay.

15 MR. CUMMINGS: That's actually my next sentence,
16 but I appreciate it. I was rambling a bit.

17 So what is this case? The case is the
18 interpretation and opinion of the taxability of a needle
19 in a haystack. One prescribed medicine out of 3,357
20 prescribed medicines sold by our client deemed taxable,
21 incredibly, by junior CDTFA field auditor and a whole
22 CDTFA legal team. This, like, magical taxable Easter egg
23 discovered by an auditor. I hold up here our Exhibit 2,
24 which is 3,357 items.

25 JUDGE ALDRICH: Just to clarify, I believe you

1 mean Exhibit 3?

2 MR. CUMMINGS: Two.

3 JUDGE ALDRICH: Three?

4 MR. CUMMINGS: Oh, maybe not.

5 JUDGE ALDRICH: Exhibit 2 would be the digital
6 version of the devices that you brought in.

7 MR. CUMMINGS: Oh, my bad. This is Exhibit 3.
8 You're correct. Thank you for the clarification.

9 So what did he do? He correctly did not charge
10 sales tax on 3,357 prescribed items, which the CDTFA
11 auditor had no problems about. No problems with this
12 entire inventory. None were deemed taxable except for one
13 item, and it was not a bowling ball, which is taxable by
14 the way. It was an item called VascuTherm. This
15 instrument here, which administers -- this is 2-1 for the
16 record -- that administers at the time hot and cold
17 treatment, cold treatment now, and compression treatment
18 to post-surgical patients to reduce swelling and reduce
19 and disperse blood clots, which can be very dangerous and
20 life threatening after surgery.

21 This is -- and I said 100 times -- a prescribed
22 medicine. It's like any of the other 3,000 items on the
23 list, but CDTFA says that this one item out of all this is
24 taxable. And we say it's not, and that's the case.

25 All right. Do I want to do this? I guess I'll

1 do it. You can shut me up. All right. I want to go
2 through some items that everybody knows about from a
3 layperson's standpoint because we're going to get to this
4 product and why it's complex. Think about it. If you buy
5 a hammer from a hardware store, is it taxable? Yes, it's
6 taxable. New car from a dealership? Yes, it's taxable.
7 How about tomato or food from a grocery store? Right?
8 Not taxable is it. Food from a restaurant, it's still
9 food. You buy the same tomato but from a restaurant --
10 maybe they slice them to make it better, like at the deli.
11 I like it that way. It's now taxable.

12 How about lawyers or CPAs, our services? No.
13 Everybody knows they're not taxable. We have pretty good
14 lobbyists, and there are some services that are, but they
15 are exceptions. And auto shops there's always the parts
16 versus the service. Anyway, I won't get into that. So
17 now it's getting tricky. If you have to-go food, is
18 taxable or nontaxable? Well, from the CDTFA website, to
19 go-sales, hot prepared food products are taxable unless
20 they are considered hot-baked goods. Hot beverages, such
21 as coffee and tea re not taxable if sold to go. But soda
22 and alcoholic beverages are always taxable.

23 I went in the other day and got my favorite
24 Perrier from Nick the Greek in The Valley, and I got two;
25 one to go, one for here. Guess what? They were both

1 taxable. I guess they consider that a soda. I think it's
2 water. The owner didn't want to fool around, so he made
3 it taxable. Sales of over-the-counter medicines are
4 taxable unless they are prescribed by a person authorized
5 to prescribe the medicine, such as a licensed physician,
6 dentist, or podiatrist, and filled by a pharmacist -- what
7 Jeff does.

8 It's interesting. All these items here, I went
9 out last night to Rite-Aid or CVS, Rite-Aid or whatever,
10 and bought them. They're all on the list 1591 as
11 prescribed medicine that are allowed. But when I bought
12 them there, they taxed. Why? Because they didn't have a
13 prescription. Okay. Anyway all of these areas I talk
14 about, car dealership, to-go places, they generally know
15 what's taxable. They make it their business. It's not
16 complicated in most cases. And for retail businesses when
17 they get registers, their point of service, it's
18 programmed in so there are no problems.

19 So when an auditor comes out, they can look at
20 the point of service. Those things are programmed in. If
21 there are changes made suddenly, you know, banana
22 sandwiches are taxable. They weren't before. They'll
23 change that on the menu and in the system so it's charged
24 correctly. So our case looks very complex. Marcus has
25 done a great job of describing the tax law as it relates

1 to this item.

2 We're all trying to figure out if this one
3 prescribed medicine out of thousands should be taxed
4 because a junior auditor on a surprise gotcha audit --
5 we're going to talk about that -- thought it should be.
6 And he's not here for us to question as we keep saying.

7 So we'll talk to the taxpayer. This is Jeff
8 VonderHaar. I have some questions.

9

10 DIRECT EXAMINATION

11 BY MR. CUMMINGS:

12 Q Mr. VonderHaar, can you state your full, name of
13 your business, and your position in the business?

14 A Jeffrey VonderHaar. Specialized Orthopedic
15 Solutions. I'm the CEO.

16 Q Describe your business. What do you sell?

17 A We are a distributor of all post-op rehab, pain
18 management modalities.

19 THE STENOGRAPHER: Sir, can I please ask you to
20 speak into the mic?

21 MR. VONDERHAAR: I'm sorry.

22 We are a distributor of all post-op rehab and
23 pain management modalities, fabrication, a facility for
24 custom orthotics and prosthetics, along with a physical
25 therapy clinic as well.

1 Q Are all the medical items you sell prescribed by
2 a doctor?

3 A Everything.

4 Q What's the process, by the way, a medical
5 prescription is filled by your firm?

6 A Once a prescription or RFA, request for
7 authorization, is received from our facility, benefits are
8 checked, ran, authorization received, and then scheduling
9 for disbursement of such product.

10 Q Do you act like a pharmacy or are you, in fact, a
11 pharmacy that you dispense these medical items and
12 treatments and so on?

13 A Not really sure. I'm not really familiar with
14 how a pharmacy works. However, I suspect it's all along
15 the same lines.

16 Q Okay. And you purchased these items from various
17 manufacturers?

18 A Several.

19 Q Have the manufacturers ever informed you that any
20 of the equipment that you sell is subject to sales tax?

21 A Never.

22 Q Okay. So let's go back in time, nine years. An
23 audit was performed and a report issued February 23rd,
24 2017 -- I believe that's what I saw in the report -- for
25 the three-year examination period 7/1/10 to 6/30/2013; is

1 that right?

2 A I'm sorry. Repeat that.

3 Q Okay. An audit was performed for the period
4 July 1st, 2010, through 6/30/2013?

5 A Correct. Correct.

6 Q Okay. When did you start providing VacuTherms,
7 about what year?

8 A Somewhere around 2009 or 2010.

9 Q Okay. Interesting.

10 A When they -- when they came out.

11 Q Okay. About when the audit started, and Mr. Luis
12 Gomez was the auditor; correct?

13 A The person who came to my facility was Mr. Gomez,
14 I believe. Yes.

15 Q Was this the first CDTFA audit you ever had?

16 A Yes.

17 Q Were you ever approached by a CDTFA
18 representative regarding sales tax in the past?

19 A Until then, no.

20 Q Did you ever pay sales tax prior to Mr. Gomez's
21 visit?

22 A No. No need to.

23 Q Why not?

24 A Because everything we dispense was via
25 prescription, and no devices or products or items, units

1 bracing, whatsoever, was I notified would be taxed.

2 Q Okay. Did the auditor schedule an appointment
3 for this?

4 A No, he didn't.

5 Q Did he send a letter?

6 A No, he did not.

7 Q All right. So he walked in from the street
8 unannounced?

9 A He did.

10 Q Did he advise you to get a lawyer or an
11 accountant experienced in the nuances of sales tax to
12 represent you?

13 A He did not.

14 Q Okay. So this surprise audit comes out of
15 nowhere. Mr. Gomez wants to see records, you know. Hi
16 there. Surprise. You're being audited; is that right?

17 A He provided his card to me from what I recall and
18 asked for specific information regarding the VascuTherm.

19 Q Okay.

20 A And then he began asking for records, like, tax
21 returns, invoicing, billing, and so on related to the
22 products he was auditing.

23 Q Correct. Yes.

24 A I should say product.

25 Q Okay. I am holding again Exhibit 3?

1 A To which I readily advised my manager to provide
2 him with whatever he needed.

3 Q Well, let's just take some random items here.
4 Did he ask for, on page 1 of this, the sterile water
5 saline 10 milliliter?

6 A No, he did not.

7 Q How about Item 64 on page 2, the skin barrier
8 powder per ounce?

9 A He did not.

10 Q Okay. How about on page 121, "Urine Ost Pch Bar
11 with Lock Fln"?

12 A He did not. By the way, for the record, what he
13 is referencing, these 3,000 products, I'm licensed and
14 accredited to provide anything within this list here.
15 That's what our license and accreditation is approved for.

16 Q This is a fee schedule?

17 A A fee schedule. A Medi-Care fee schedule.

18 Q That's right. Anyway, I can bore everybody and
19 go through all of these items, but I think we already know
20 if we go to page 12 here -- and there are accessories to
21 this particular unit. But on page 12 I've highlighted in
22 the exhibit that I sent off electronically, the
23 VascuTherm, water, circulating heat pump. This is all he
24 really cared about; right?

25 A Just the sole item, correct.

1 Q Okay.

2 A And the corresponding billable codes.

3 Q Okay.

4 A Which I have four.

5 Q Got it. Stupid question. Are these VascuTherm
6 units a prescribed medicine?

7 A Yes.

8 Q Okay. So you complied with him, and I think you
9 said your manager provided the paperwork of the total
10 sales for these units for the three-year period?

11 A That's correct.

12 Q And the total VascuTherm sales -- there are some
13 other minor items -- but were over \$2 million, which
14 resulted in \$230,000 in proposed sales tax?

15 A That sounds about right. Yes.

16 Q Okay. Did you have, at the time, any idea why he
17 was asking for information related to these?

18 A Absolutely no idea.

19 Q Did you get any advice from anyone, any
20 manufacturer, friends? I know you didn't call me. I'm
21 your CPA.

22 MR. CUMMINGS: By the way, I should point that
23 out. I am Jeff's CPA. I do his federal tax and other tax
24 matters.

25 ///

1 BY MR. CUMMINGS:

2 Q So did you get any advice from anyone else about
3 the audit of taxability of the unit?

4 A No. I, actually, during the time that gentleman,
5 Mr. Gomez, was there and my manager was working with, him,
6 I stepped out to call the manufacturer of that specific
7 product in question to find out if they knew of any
8 history or understanding of a taxation. Which he replied
9 no, he was not aware of it.

10 Q Well, did Mr. Gomez offer to you that you might
11 begin charging sales tax in the future? In other words,
12 did he offer any education or information regarding this
13 very rare and unique sales tax treatment of this
14 particular item?

15 A No, he did not.

16 Q He didn't say you should start collecting tax in
17 the future, that it might be interpreted as a taxable
18 item?

19 A Not at all.

20 Q Okay. Did he ever review with you, during the
21 audit but prior to his final determination, the section of
22 sales tax law he thought you might be subject to?

23 A I'm sorry. Repeat that again.

24 Q Did -- yeah, it's a confusing sentence.

25 Did he review with you? Did he say here's the

1 tax law that I think this unit would apply to.

2 A No, he did not. There was no reason given as to
3 why that specific product was under the microscope.

4 Q Okay. Did he bring up -- where is that? All
5 right. I believe it's -- there's Exhibit F. I don't have
6 a list of exhibits straight in front of me. It should be
7 the summary executive -- could someone read off Exhibit 7?

8 A And, for the record, if I might add, this
9 specific product, this item, however you want to call it,
10 has four different modalities. Not only, first and
11 foremost a DVT prophylaxis. These wraps go around the
12 ankles.

13 THE STENOGRAPHER: Did you say DPT?

14 MR. VONDERHAAR: DVT, deep vein thrombosis. DVT
15 prophylaxis for PE, pulmonary embolism.

16 BY MR. CUMMINGS:

17 Q We will get to that.

18 A Along with compression for any specific joint
19 while circulating a temperature-controlled therapy through
20 those individual bads, be it heat, be it cold, be it a
21 combination thereof. So there's several different things
22 happening at one time. It's not just one of the
23 modalities. At least three of them are happening during
24 that treatment phase, and I think it's important to note
25 that.

1 Q Thanks, Jeff. All right. So I have Exhibit F.
2 It's the -- from the CDTFA, the summary analysis petition
3 for redetermination. It has in it some annotations from
4 prior audits that were performed by the CDTFA that gave an
5 opinion about a unit similar to this. Did he ever share
6 with you those annotations?

7 A I'm sorry. Repeat that.

8 Q Okay. There are these annotations that are part
9 of what is called Exhibit F. Annotations are opinions
10 that the CDTFA anoints in their records when they have --
11 typically, it's a position that has -- it's like a tax
12 wobbler. It can go this way or that. There's
13 interpretation that they need. And then they need to
14 make -- when they make a determination, it's not from a
15 judge. It doesn't come from law. It comes from auditor
16 of prior cases, and they use that as reference. Did he
17 show you, like, hey look. In a prior audit we said this
18 thing was taxable.

19 A Nope. No, he did not.

20 Q Okay. After Mr. Gomez completed the audit, you
21 received a bill for about \$230,000?

22 A Correct.

23 Q The balance is now, with interest and penalties,
24 I believe it's over \$350,000 as of the last bill; is that
25 right?

1 A I believe \$360,000.

2 Q After you got the bill, you disagreed with the
3 findings with the CDTFA, and you had some discussions and
4 sent over several mails -- emails, memos disagreeing with
5 them regarding their decision on the VascuTherm; right?

6 A I did, yes.

7 Q And then you filed a timely appeal with the
8 CDTFA, which is why we're here?

9 A Yes. Correct.

10 Q I want to emphasize again that you did not
11 collect any sales tax on any of the items in your
12 inventory prior to the audit?

13 A That is correct.

14 Q Okay. Since the audit, have you been charging
15 taxes for VascuTherm?

16 A Yes.

17 Q And is that still the only -- and is that the
18 only item deemed taxable in your inventory prescribed
19 medicines?

20 A In fact, I've been doing both. I've been paying
21 taxes on the purchase of the pads and the new units we
22 buy. And then if we're unable to bill the insurances,
23 then we tax the patient for rental, and we pay that for
24 both --

25 Q All right. So you've been basically scared to --

1 A -- just to cover ourselves --

2 Q Cover yourselves.

3 A -- at both ends.

4 Q Right.

5 A I don't want to go through anymore of this.

6 Q So now you can -- you kind of described it. But
7 why don't you fully describe what this VascuTherm unit
8 does?

9 A Again --

10 JUDGE ALDRICH: Mr. Cummings, would it be helpful
11 to zoom in as you give the example? Or is --

12 MR. CUMMINGS: Yeah. You can zoom in on the
13 equipment.

14 JUDGE ALDRICH: Okay.

15 MR. CUMMINGS: Do you want to show it? Maybe you
16 can do a little --

17 MR. VONDERHAAR: So these are the -- these are
18 the DVT prophylaxis cuffs --

19 JUDGE ALDRICH: If you could --

20 MR. VONDERHAAR: Sure.

21 JUDGE ALDRICH: Maybe --

22 MR. FRISHMAN: Come in the front? Maybe move it
23 over here. See where -- move it over here and then you'll
24 be picked up on the camera. You have your Oscar moment.

25 MR. VONDERHAAR: Put on the cuffs --

1 MR. CUMMINGS: Oh, maybe move this over here, and
2 then you sit here. Yeah?

3 MR. VONDERHAAR: Okay. The white cuffs that I'm
4 referencing, the calf wraps. There is 55 millimeters of
5 mercury that are pushed through there intermittently. 30
6 seconds on the right -- oh, sorry. 60 seconds on the
7 right, inflates, and then deflates on the left. Back and
8 forth. That's to ensure blood flow while the patient is
9 not ambulating, while they are resting. And they could,
10 for any procedure, whether in the hospital for those one
11 to two days. Anyone that's had a surgical procedure would
12 understand this. And then your risk for a DVT or PE,
13 pulmonary embolism, within 28 days of being discharged
14 from the hospital following any type of major surgery.

15 The other wraps, you'll see that black one there.
16 It has each -- we have one for each and every joint. You
17 have for the shoulder, the elbow, the knee, the ankle, the
18 hip. What it does is you get a level of compression, low,
19 medium, high grade with temperature-controlled therapy,
20 from 43 to 105 degrees. So you get ice therapy with
21 compression for pain management. Of course the
22 compression, whatever grade it is for edema. It's to help
23 keep the swelling from building up around that surgical
24 site.

25 Then we have, again, the DVT. So they can use

1 contrast, ramps up to 105 for 10 minutes, drops down to 43
2 degrees for 20 minutes back and forth, back and forth. It
3 doesn't require ice. It's a very convenient way to apply
4 edema control pain management to prevent them from having
5 to take oral medication, which is a big deal. Certainly
6 back -- what should have happened a long, long time before
7 2010.

8 So there's a multitude of four, specifically,
9 modalities that one product renders, and they are used in
10 combination with each other. It's not just one that's
11 being prescribed. The unit is being prescribed. From a
12 billing standpoint, I'm unable to bill all four.
13 Although, we apply all four, I can only bill one of
14 those -- of the billing codes. I hope that is a better
15 understanding of what it's capable of doing.

16 BY MR. CUMMINGS:

17 Q So could you describe, this is used -- this
18 VascuTherm fluid is --

19 JUDGE ALDRICH: Mr. Cummings, could you identify
20 it?

21 MR. CUMMINGS: This is a -- this is what's called
22 VascuTherm fluid. It's Exhibit 2.2.

23 JUDGE ALDRICH: Thank you.

24 MR. CUMMINGS: 2.2.

25 MR. VONDERHAAR: It's the fluid that goes in

1 there instead of having to -- we don't use ice. It's
2 temperature controlled internally. It's a fluid of
3 distilled water and isopropyl alcohol.

4 BY MR. CUMMINGS:

5 Q My understanding is it's 70 percent alcohol --

6 A That's correct.

7 Q -- and 30 percent distilled water. It's also
8 called nonpyrogenic water or sterile water. In other
9 words, it won't give you a fever. It's sterile. It's
10 free of pathogens. So and it's this fluid that
11 administers the treatment for this edema-swelled body
12 parts and help prevent blood clots; right? This is a key
13 dispensing, sort of, item? Yeah?

14 A That is pushed through the -- and vocals. Yes.

15 Q Could we say that VascuTherm is used to
16 administer this treatment similar to syringe dispensing
17 penicillin or a tube dispensing ointment or oxygen --

18 A Probably oxygen concentrator dispensing O2 to a
19 patient in need of it.

20 Q Okay. What are the treatments? What are the
21 other type of -- well, I'll do this. Could you go through
22 Exhibit 2-12 and read off examples of the types of
23 problems people have. And these are prescriptions,
24 correct, from doctors to get a VascuTherm.

25 A Sure.

1 Q So if go over, you can kind of read through what
2 they are and tell us more about what --

3 A Well, this device could be used for a number of
4 procedures. Again, specifically, anything where a DVT
5 prophylaxis or pulmonary embolism is, is possible
6 following a surgery for patients or doctors who do not
7 want their patients to have to mitigate or minimize the
8 amount of oral pain medications they take, or for that
9 medication for circulation.

10 Specifically in this case is for a total hips,
11 total knee orthopraxy, total hip orthopraxy, rotator cuff
12 repair and surgery. Same thing with foot and ankle
13 fusions or a myriad of any type of patients we see like
14 that.

15 Q Have you -- this will seem like a strange
16 question, but this comes straight out of Section Reg 1591.
17 Have you ever filled prescription for VascuTherm ever --
18 have you ever filled a prescription for this unit to be
19 used to treat male impotency?

20 A I'm sorry. Repeat that.

21 Q Have you ever filled a prescription where the
22 prescription said this unit was to be used to treat male
23 impotency?

24 A No.

25 Q Okay. Did the auditor ask you if the unit was

1 used to treat male impotency?

2 A No.

3 Q Did the auditor ask to see any VascuTherm
4 prescriptions to see how it's used?

5 A No.

6 Q And is VascuTherm a prosthetic device? And let
7 me read the definition of -- prosthetic device is a device
8 designed to replace a missing body part of the body or to
9 make a part of the body work better. So under the
10 definition, would this be a prosthetic device?

11 A A prosthetic device? No.

12 MR. CUMMINGS: Okay. That's the questions I have
13 now. Now I have a couple of comments.

14 JUDGE ALDRICH: Before going onto your comments,
15 I was wondering if you could identify each of those --

16 MR. CUMMINGS: I will.

17 JUDGE ALDRICH: Okay.

18

19 PRESENTATION

20 MR. CUMMINGS: Part of the comments. Yeah. Very
21 good. You're always one step ahead of me. Let's see.
22 Okay. All right.

23 So let's start with the mission on the CDTFA
24 website. What does it say? The mission of the CDTFA is
25 to make life better for Californians by fairly and

1 efficiently collecting the revenue that supports our
2 essential public services. So let's start regarding this
3 audit. Is it efficient? Clearly not. It's been since
4 six years since the audit, at least. The client has spent
5 considerable time and money defending himself. We've
6 spent lots of time on the case. CDTFA lawyers have
7 written multiple-page briefs --

8 THE STENOGRAPHER: Mr. Cummings, can you slow
9 down a little bit, please.

10 MR. CUMMINGS: -- researched ad nauseam sales tax
11 law, and now we're here.

12 Again it's -- the mission of CDTFA is to fairly
13 collect it. Was this fair? Well, if this was auditing
14 food sales, which is nontaxable. Hammers, they're
15 taxable. That's easy. Our accountant and lawyer
16 services, not taxable. It would be easy. There's no
17 argument. And if Jeff understated the tax, or collected
18 and did not remit it, we would not be here.

19 So what could the junior auditor have done to be
20 more fair in this case on this surprise visit? Well, he
21 could have told Jeff -- and by the way, this is in purview
22 of auditors. I was an auditor, and we've experienced
23 other auditors. Like a traffic cop, he can pull you over
24 and he can give you a warning. He says from now on I
25 don't want to see you on your cell phone, or that stop was

1 a rolling stop sign. They don't always give you tickets,
2 right?

3 He could say, listen, CDTFA has an opinion. It's
4 an annotation. It doesn't matter. You don't have to know
5 the technicality where one item in your inventory might be
6 deemed taxable. So he should start collecting sales tax
7 just to make sure for this item -- I'll slow down -- and
8 report it and remit the money to the CDTFA. Instead, he
9 specifically comes to SOS Medical armed with billing codes
10 for a specific unit he believes he can get an easy win.

11 When I was an auditor, we called these audits
12 low-hanging fruit, slam dunk audits, and gotcha audits.
13 But does he give information? Does he say, in the future
14 look, this item it looks taxable. We've -- we've had some
15 opinions in the past. No, he doesn't. He slaps Jeff with
16 a bill, which is now \$350,000 and -- and now we have to
17 get into these weird esoteric arguments over the
18 definition of preparation treatment substances, which is,
19 of course, the essence of this case.

20 The professionalism of this audit, generally, the
21 CDTFA -- when we generally see audits, we go out. E
22 represent clients. They send a letter to a client
23 informing him or her or they -- my teenage daughter -- of
24 an up coming audit. This was an unannounced fishing
25 expedition. It's a term I actually heard from a CDTFA

1 auditor years ago. Sometimes we just do fishing
2 expeditions.

3 And this junior auditor clearly zeroed in on this
4 one unit to try -- to try to tax out of the 5,000 on the
5 list. It caught the client off guard and didn't inform
6 him of his right to seek representation. I don't think
7 it's a requirement. There's no Miranda rights as far as I
8 can tell. Anyway, I grade him a D in terms of
9 professionalism.

10 Here's an interesting fact. As I mentioned I'm
11 the CPA SOS Medical, which is a small business. The
12 company actually lost about \$95,000. Jeff said I could --
13 I could -- I could divulge this information. In 2022 they
14 were still suffering due to the pandemic, as a lot of
15 small businesses did. Jeff needed to get PPP loans. I
16 helped him with that. This year so far, their up-net
17 income about \$100,000 through August. Not a lot. Not a
18 lot. If the CDTFA prevails, he'll personally -- he has a
19 pass through S corporation -- personally have to pay the
20 \$350,000 out of his pocket because he didn't collect the
21 sales tax on this strange item.

22 The business at the end of August -- we do the
23 books -- had about \$130,000 in the business checking
24 account, and this bill will bankrupt his business. Now, I
25 would not feel bad for Jeff if he had to pay this bill, if

1 he collected the sales tax, or he lied or misstated his
2 income or it was clearly something like food or taxable
3 hammers or whatever, that he just didn't remit, or he
4 didn't charge. But he didn't do any of these things. He
5 appeared to correctly treat the item he sold as a
6 nontaxable prescribed medicine, and he didn't charge the
7 patients tax for this.

8 I already pointed out the Exhibit F, the
9 annotations and what they are. I'm pointing it out
10 because I'm hoping that none of you will put reliance on
11 this. They are not case law. They are not precedent.
12 They are not regulation. They just anoint or document
13 what we feel was the same wrong decisions on the other
14 audits that were done.

15 All right. I want to get to the crux of the
16 case. Let's talk about the law. You guys can reference,
17 if I want to pull it out, CDTFA Exhibit B. I made copies
18 because I want to, like -- I don't know if it's
19 appropriate. I made copies of 1591 straight from the
20 CDTFA last night because I realized Mr. Dang, when he
21 wrote his supplemental appeal, the March 18th, 2018, took
22 items out of context. He actually eliminated some things
23 that were straight --

24 MR. FRISHMAN: Similar.

25 MR. CUMMINGS: -- one of the -- no, that were in

1 the regulation. He, like, left them out. I guess I could
2 read it, right? I mean, you guys don't have to read
3 along, if you want. But let's -- let me do this. And
4 then there's also the Appeal of Supplemental Decisions.
5 Let me -- let gather this for a moment.

6 JUDGE ALDRICH: Mr. Cummins, we do have the
7 regulation available to us.

8 MR. CUMMINGS: Okay. And I'll just refer.

9 JUDGE ALDRICH: If I could direct you back to
10 Exhibit 2-1 through, et cetera, could you please identify
11 each of those?

12 MR. CUMMINGS: Okay. All right. 2-4 is topical
13 cream used to treat skin conditions. Let's see here. Can
14 I stand up here.

15 MR. FRISHMAN: Tell him the reason you're
16 pointing those out.

17 MR. CUMMINGS: Well, I'll get to them later
18 'cause it's not now because I'm not at that point.

19 2-5 is an enema preparation. It's a device that
20 delivers liquid when people are constipated.

21 I guess I'll bring it up now. The reason why
22 this is important is this has fluid in it that dispenses a
23 substance to a human being that gets a prescription for a
24 particular diagnosis. If you're prescribed this, this is
25 nontaxable, and it's in the -- it's on the list.

1 Hydrogen peroxide, Exhibit 2-6, six is
2 specifically listed in Section 1591 as a nontaxable item,
3 if it's prescribed. Surprisingly enough, baby powder
4 also, Exhibit 2-7, is nontaxable. I want to go to that
5 portion of the regulation. Rubbing alcohol 70 percent is
6 also nontaxable. And of all things, baby lotion. You
7 know, you would think this would be taxable, but it's not.
8 Babies get diaper rash, I have five kids. It can get
9 really serious, and I guess the State says we want people
10 to not be taxed for this thing because it's very
11 uncomfortable.

12 JUDGE ALDRICH: For clarity, you're referencing
13 Exhibit 2-10?

14 MR. CUMMINGS: 2-10, correct.

15 2-11 is aspirin, which everybody knows is taxable
16 if you buy it at Right Aid. But if you get the same
17 prescript -- the same dosage, which I've had before, from
18 a doctor, no tax is paid.

19 This Item 2-9 I'd like to get to later. Sorry
20 about that. We've already talked about the VascuTherm.
21 So I don't know. I'll spend half a moment --

22 JUDGE ALDRICH: Mr. Cummings, could you just
23 identify 2-9, please.

24 MR. CUMMINGS: All right. 2-9, Jeff, what do you
25 call this?

1 MR. VONDERHAAR: That's an EMS device, an
2 electrical muscle stimulator.

3 MR. CUMMINGS: And electrical muscle stimulator.
4 Right.

5 JUDGE ALDRICH: Sorry to have to remind you, but
6 it is really important to speak into the microphone.

7 MR. CUMMINGS: Okay.

8 JUDGE ALDRICH: Okay. So those items have been
9 caught on camera.

10 MR. CUMMINGS: Right.

11 JUDGE ALDRICH: Would it be all right to resume
12 the normal view?

13 MR. CUMMINGS: Yeah. That's fine.

14 JUDGE ALDRICH: All right. Judge Tay. Thank
15 you.

16 MR. CUMMINGS: All right. Do you have the --
17 here it is. I got it. Too much paperwork.

18 MR. FRISHMAN: Second to last page.

19 MR. CUMMINGS: Yeah. Okay. This is what's --
20 this is what's very strange about Exhibit B. If you go to
21 the second to last page --

22 MR. FRISHMAN: Five.

23 MR. CUMMINGS: -- page 5. Then I have to
24 reference this. This is hard to find. If I go to the --

25 MR. FRISHMAN: Tell them what the document is.

1 MR. CUMMINGS: Yeah. Just a second. I should
2 have put the little Post-its, right. That's why I use
3 Post-its. Okay. Page 5 of the -- it's called the --
4 what's it called? It doesn't give a name for the this,
5 but it is a decision a, supplemental decision, I guess, by
6 Nguyen Dang, dated March 16th, 2018. On page 5, line 12,
7 it starts with respect to the petitioner's contention that
8 its sales and leases of the pneumatic compression and hot
9 and cold therapy units qualify as exempt sales and
10 medicines because the items are used to treat or prevent
11 disease and only could be obtained via a physician's
12 prescription.

13 I'll paraphrase this. Regulation 1594
14 subdivision (a)(9)(b) defines a medicine in relevant part
15 as a preparation or similar substance -- it sounds
16 familiar. Marcus was talking about it. -- intended for
17 use by external or internal application to the human body
18 in the diagnoses, cure, and mitigation treatment or
19 prevention of disease; and which are commonly recognized
20 as a substance or preparation intended for such. These
21 items include -- now, this is where it gets interesting --
22 but are not limited to drugs, such as penicillin, other
23 antibiotics, aspirin, baby lotion -- right? We went over
24 that. -- oil -- I don't know what that is -- lubricating
25 jelly, hydrogen peroxide here, topical creams and

1 ointments -- we have that here -- and vaccines, which I
2 don't have.

3 Thus, for a sale of medicine to be exempt under
4 Section 6369 and regulation 1591, not only must the
5 property in question be used to treat or prevent disease
6 and so on, but here's what's interesting. If we go to the
7 regulation -- the actual regulation, he leaves off a very
8 important thing. Preparations and similar substances
9 include but are not limited to -- I'm reading from the
10 Regulation 1591 -- limited to drugs, such as penicillin,
11 other antibiotics, dangerous drugs -- those are controlled
12 drugs like Adderall -- drugs that require dispensing only
13 on prescriptions -- for some reason that's not here -- and
14 alcohol, 70 percent solution.

15 This VascuTherm is a 70 percent solution of
16 alcohol and something else, which is nonpyrogenic
17 distilled water. That's what's in this. That is actually
18 in the regulation as an approved substance. So it's
19 specifically listed. It is administered from this unit
20 just like we could say this enema device administers the
21 fluid, just like this hydrogen peroxide bottle is used to
22 administer it to a wound or a cut. We have a thing -- as
23 Marcus talked about -- that provides a treatment to
24 someone with a prescribed prescription for a disease. But
25 he left off the alcohol solution in his memo. He pulled

1 it out. I don't know why. If you're going to quote --
2 quote the regulation, why would you leave that out? I
3 don't know. It is a mystery. I don't think it's good.

4 We -- one of our things that we're talking about
5 is, is this device similar -- does it -- to these other
6 items. Well, not only is it similar, it's exact. The
7 alcohol and the sterile solution is specifically in this,
8 and the auditor never realized it. Otherwise, I think --
9 I think he would not have bothered to slap \$250,000 on our
10 client. Okay.

11 Now, this is an area where my colleague and I
12 have disagreed. And that is that one of the things that I
13 will probably hear is, is this a device? Is it a
14 prosthetic? Is it this? Is it that? It's not treatment.
15 We say it's treatment. They'll say it's a piece of
16 equipment and, therefore, it should be taxed. But here's
17 another thing that's rather odd, and that is in 1591.
18 Let's say we lose the argument, and you guys decide well,
19 this is not just treatment. This is really -- this is
20 equipment. This is something that's tangible. We should
21 tax it.

22 There's actually something that kind of looks
23 like -- not kind of -- that looks like our device that is
24 exempt. It was never mentioned. And, again, it's in
25 1591.

1 You're going to have to give me a moment to find
2 it.

3 JUDGE ALDRICH: Just as a forewarning, you have
4 about nine minutes left.

5 MR. CUMMINGS: I'm almost done. Where is that?
6 Hold on a minute. Next time I will have Post-its. Un
7 momento. Okay. Here we go.

8 Regulation 1591. Now, we contend this is not a
9 prosthetic device. It's not something that's worn like a
10 prosthetic leg or something. But let's say you say, okay,
11 we think this is a device. And you say we think it's a
12 prosthetic device. But we don't think it is, but you say
13 it is. Prosthetic devices that do not qualify as
14 medicines include but are not limited to air compression
15 pumps, pneumatic garments, noninvasive temporary pace
16 makers, and then vacuum constrictive devices used to treat
17 male impotency. That's why I asked Jeff that question.

18 And what's interesting is that this doesn't say
19 like temporary pace makers. If we're fighting temporary
20 pace makers, you could say it's a temporary pace maker.
21 It's right here in 1591. They don't qualify as a
22 medicine. This says, okay, vacuum constrictive device,
23 but if you're using it to treat male impotency, it's not a
24 medicine. This is not used to treat male impotency in
25 Jeff's business. I asked him, and we looked at these. I

1 asked him to send over, like, five or six examples
2 yesterday of prescriptions. And all of them were edema,
3 swelling, shoulder surgery, all of these kinds of things.

4 So I think we win both ways if you go that way.
5 But I think what's more important is that this a substance
6 and a treatment. But why do they have this clarification
7 that if it's used for -- to treat male impotency, it
8 should be taxed. Well, if it's used for stimulation,
9 someone uses it for sexual stimulation -- I'm not going to
10 demonstrate it -- it's like a penis pump, as my kids that
11 were laughing as I was telling them this. That's my
12 daughter who said this. But it's very similar to cannabis
13 because the prescribed use is important from a sales tax
14 standpoint.

15 Before I came here, I went into a cannabis place.
16 And I said to them, hey, if I have a prescription for
17 cannabis, is it taxable? And they said, no, of course
18 not, but you need a special card for a prescription. You
19 guys should know that. There's big deal to make it
20 taxable. If you buy cannabis for recreational use, it's
21 taxable. And the State has taken advantage of it because
22 there was only medicinal cannabis for years. And guess
23 what the millennials did? They stopped drinking as much
24 beer and wine like their parents, and they use cannabis.
25 And the State was losing money. So they made a statutory

1 change, and they made recreational cannabis legal in.
2 California. It's still not for the fed, and they made it
3 taxable.

4 So this is very similar to that. Because if you
5 use this for fun as a sexual device, it's taxable. But if
6 you don't, it should be not taxable. Anyway, I want to
7 leave you with this. Not only we believe these
8 preparations and substances are similar to VascuTherm as
9 medicine, why would the CDTFA deliberately leave out of
10 that exhibit the description that alcohol and isopropyl
11 solution, which is -- unless they knew, which I suspect
12 they did -- that that's what this unit delivered.

13 I want to give Mr. Dang the benefit of the doubt.
14 I wanted to, that there was an amendment to the regulation
15 adding the alcohol and isopropyl, but no. In the
16 regulation history, it was not added later afterwards. He
17 just edited out this key piece of information in his
18 submission. So it's kind of a smoking gun to me. I mean,
19 you're going to make your own conclusion, but to me I
20 think it's rather deliberately deceptive. I had to look
21 very closely to find this rather striking omission.
22 Nevertheless, I think Regulation 1591 clearly indicates
23 that this unit is a medical preparation and/or substance
24 that should fall under tax exempt medicine.

25 Thank you.

1 JUDGE ALDRICH: Thank you.

2 And, CDTFA, did you have any questions for
3 Mr. VonderHaar?

4 MS. JACOBS: No questions. Thank you.

5 JUDGE ALDRICH: Okay. I do have some questions
6 for Mr. VonderHaar. Would it be possible for you to move
7 up to table?

8 MR. VONDERHAAR: Absolutely.

9 JUDGE ALDRICH: So with respect to the VascuTherm
10 device, you indicated that there were four different
11 medical codings?

12 MR. VONDERHAAR: Correct.

13 JUDGE ALDRICH: And in each of them was there a
14 difference between what was provided for those codings?
15 So, for example, did they include the device itself, the
16 tubing, the alcohol, the white compression --

17 MR. VONDERHAAR: So the order would come across
18 for cold compression with DVT prophylaxis. So once that's
19 applied, the cuffs would be applied to the patient, along
20 with -- this is actually a brace that's with the knee of
21 the knee wrap. But these three items, not the black brace
22 on top, but the white one underneath, would be the three
23 that would be applied to that patient, any given patient.
24 And that's majority, if not all, of the cases.

25 JUDGE ALDRICH: And the alcohol would be supplied

1 separately or under a separate --

2 MR. VONDERHAAR: Within the device.

3 JUDGE ALDRICH: Within the device.

4 MR. VONDERHAAR: It's all poured within the
5 device, correct.

6 MR. FRISHMAN: All under the same code?

7 MR. VONDERHAAR: No. There are separate codes
8 for the wrap. There are separate codes for this wrap, and
9 there are separate codes for the unit itself. There's
10 four modalities as I indicated prior. I can only bill for
11 one of them.

12 JUDGE ALDRICH: Got it.

13 MR. VONDERHAAR: So it would be E0218, E0217,
14 E0650, or the E1399, along with the individual wraps.

15 JUDGE ALDRICH: Okay. My colleagues may have
16 questions for you when I'm done at this time.

17 MR. VONDERHAAR: Sure.

18 JUDGE ALDRICH: So my question is for
19 Mr. Frishman. Would you describe this appeal as a legal
20 issue or an audit issue?

21 MR. FRISHMAN: Legal issue.

22 JUDGE ALDRICH: Okay. And it seems, if I'm
23 hearing your argument correctly, that you're saying that
24 this device is medicine. Is that not --

25 MR. FRISHMAN: This device is medicine, and this

1 device is similar. Well, understand CDTFA's position is
2 it is medicine. They say that in their final decision on
3 their final page --

4 JUDGE ALDRICH: I'm asking for your position.

5 MR. FRISHMAN: -- but is it similar? Excuse me.
6 What?

7 JUDGE ALDRICH: Your position, though.

8 MR. FRISHMAN: Yes, our position is it's similar,
9 and it's medicine.

10 JUDGE ALDRICH: Okay.

11 MR. FRISHMAN: And it's used to treat diseases.

12 JUDGE ALDRICH: Okay. And then -- thank you.

13 MR. FRISHMAN: It's not -- yeah. It's not a
14 listed excluded device. Yeah.

15 MMR. VONDERHAAR: And if I may add, treatment and
16 preventive.

17 MR. FRISHMAN: Sure. It's along the treatment
18 and prevention --

19 MR. VONDERHAAR: Treatment and prevention of.

20 MR. FRISHMAN: Yeah.

21 JUDGE ALDRICH: Did you get that?

22 THE STENOGRAPHER: I did. Thank you.

23 JUDGE ALDRICH: Okay. Thank you.

24 Judge Geary, did you have any questions?

25 JUDGE GEARY: I do for Mr. VonderHaar. The

1 alcohol solution goes in the machine; correct?

2 MR. VONDERHAAR: Correct.

3 JUDGE ALDRICH: And it's the alcohol solution
4 that delivers the heat and cold to the patient?

5 MR. VONDERHAAR: No. The device actually does.
6 It's in lieu of ice. We have the solution that goes
7 inside. So it's there to prevent it from building up any
8 type of minerals and prevent the solution from freezing.

9 JUDGE GEARY: How the device creates cold?

10 MR. VONDERHAAR: That's beyond my knowledge.
11 There's a generator in there. So it drops it down to
12 43 degrees. But prior to 2014, they dropped as low as 37
13 degrees, and they ramp up to 105. So we can push -- press
14 a button on there and add contrast to 105, contrast and
15 cooling all the way down to 43 degrees, or use one or the
16 other all the while administering compression to that
17 joint and DVT prophylaxis --

18 JUDGE GEARY: You can --

19 MR. VONDERHAAR: -- meaning, compression to the
20 calves. I apologize. Go ahead.

21 JUDGE GEARY: So you can't tell me exactly what
22 is in the machine before you -- are you saying without the
23 alcohol, that machine will still produce heat and cold at
24 the -- at the pad point?

25 MR. VONDERHAAR: No. You have to have solution

1 in it.

2 JUDGE GEARY: Okay.

3 MR. VONDERHAAR: There's got to be a solution in
4 there.

5 JUDGE GEARY: Okay. But in your mind, you don't
6 think the solution is actually the medium that carries the
7 heat and cold?

8 MR. VONDERHAAR: Potentially. Sure.

9 JUDGE GEARY: But you don't know one way or the
10 other?

11 MR. VONDERHAAR: I couldn't tell you that.

12 JUDGE GEARY: When a client, customer finishes a
13 treatment, the alcohol is still in the machine; correct?

14 MR. VONDERHAAR: Absolutely.

15 JUDGE GEARY: None of it delivered into the
16 patient's body?

17 MR. VONDERHAAR: No.

18 JUDGE GEARY: You said you can only bill one of
19 the codes of the four that can be utilized with this
20 machine; is that correct?

21 MR. VONDERHAAR: Correct. Yes.

22 JUDGE GEARY: Which one can you bill?

23 MR. VONDERHAAR: Say that again. I'm sorry.

24 JUDGE GEARY: Which one can you bill?

25 MR. VONDERHAAR: All four of them billable. They

1 are all four billable.

2 JUDGE GEARY: Oh, I thought you said in your
3 testimony that --

4 MR. VONDERHAAR: No, no, no. But at one time.
5 So I can bill any one individually.

6 JUDGE GEARY: Okay. Thank you.

7 MR. FRISHMAN: Good point.

8 JUDGE GEARY: The code designations -- that's all
9 Medi-Care stuff; right? All Medi-Care codes?

10 MR. VONDERHAAR: Medi-Care. Of course, Workman's
11 Comp or PI would require something different. So we would
12 do an E139, which is a miscellaneous code to encompass all
13 those different modalities that have been utilized.

14 JUDGE GEARY: Are the codes some kind of a
15 universal coding system that various organizations use?

16 MR. VONDERHAAR: Yes, it is. I would say that.
17 Yeah.

18 JUDGE GEARY: Is it a coding system developed by
19 the Centers for Medi-Care and Medicaid?

20 MR. VONDERHAAR: So there's a fee schedule
21 through Medi-Care, and it lists all the various codes. It
22 will say specifically a cold therapy treatment, E0218.
23 That would be listed, which is what this provides. E0217
24 would be heat. E0650 is for compression. E0676 is for
25 the for the DVT prophylaxis. Now what -- again, with

1 Medi-Care it's different from, like, Work-Comp. Work-Comp
2 would encompass all of them.

3 MR. CUMMINGS: With different codes.

4 MR. VONDERHAAR: Which would be a miscellaneous
5 code. Which an E139 --

6 MR. FRISHMAN: Let me point out something.
7 Work-Comp is not an insurance company. It's not relevant.

8 MR. VONDERHAAR: I'm saying the way in which --
9 I'm just giving the way in which it's billed.

10 JUDGE GEARY: I understand.

11 MR. VONDERHAAR: Yes.

12 JUDGE GEARY: Thank you, Mr. VonderHaar. That's
13 all I have.

14 MR. VONDERHAAR: Sure. Of course.

15 JUDGE ALDRICH: Excuse me. Judge Tay, did you
16 have any questions?

17 JUDGE TAY: I'll hold my questions for later.
18 Thank you.

19 JUDGE ALDRICH: Mr. VonderHaar, with respect to
20 the electronic stimulating device, could you tell me a
21 little bit more about that? What comes in the package?

22 MR. VONDERHAAR: The device itself, it has lead
23 wires, which are bunched up here.

24 JUDGE ALDRICH: Could you --

25 MR. VONDERHAAR: I apologize. So we have the

1 device itself --

2 JUDGE ALDRICH: Okay.

3 MR. VONDERHAAR: -- along with the lead wires,
4 and at the end you'll find the electrode. So the
5 treatment is -- actually, this goes on the patient, and
6 the control panel is essentially here. It's electrical
7 stimulation for disuse atrophy or prevention therefore.

8 JUDGE ALDRICH: Sorry.

9 MR. VONDERHAAR: Atrophy -- muscle atrophy,
10 that's what it's designed for and for pain management.

11 JUDGE ALDRICH: Presumably the patient or the
12 person using it can control the -- with varying --

13 MR. VONDERHAAR: They do indeed.

14 JUDGE ALDRICH: Okay.

15 MR. VONDERHAAR: Yeah. So our technician would
16 educate the patient on how to properly use it based on the
17 prescription received from the physician. And that in
18 turn is to provide them with not only oral, but written
19 instructions on how to properly use it.

20 MR. CUMMINGS: The reason that I had this was
21 that I was -- I wanted to show -- this is an exempt item.
22 I wanted to show how there's a similarity in that you have
23 a piece here that's sort of controlling what's being
24 administered, electrical current to where it is on the
25 body. Same thing here. This is sort of controlling the

1 substances that are going to go into the human body.

2 Exempt, potentially taxable.

3 MR. FRISHMAN: It's a conflict.

4 MR. CUMMINGS: It's a conflict.

5 JUDGE ALDRICH: Okay. Thank you.

6 So, CDTFA, at this time are you ready to proceed
7 with your opening and closing presentation?

8 MR. FRISHMAN: May I ask a question?

9 JUDGE ALDRICH: Yes.

10 MR. FRISHMAN: Do we get closing remarks?

11 JUDGE ALDRICH: Yes.

12 MS. JACOBS: Yes. Thank you.

13

14 PRESENTATION

15 MS. JACOBS: As you're aware, under the Revenue &
16 Taxation Code Sections 6012 and 6051, sales tax applies to
17 a retailer's gross receipts from the retail sale of
18 tangible personal property, or TPP, in this state, unless
19 the sale is specifically exempt or excluded from taxation
20 by statute. A retailer's gross receipts are presumed to
21 be taxable until proven otherwise, and the burden is on
22 the retailer to establish that its retail sales are not
23 subject to tax.

24 Statutes granting a tax exemption are strictly
25 construed to avoid enlarging or extending the concession

1 beyond the plain meaning of the language used in granting
2 it. See Associated Beverage Company versus Board of
3 Equalization 1990 224 Cal.App. 3D 191 pincite 211.
4 Appellant bears the burden of showing it comes within the
5 terms of the exemption by a preponderance of the evidence.
6 See regulation 35003(a) and Payne versus State Board of
7 Equalization 1982 137 Cal.App. 3D 438 pincite 443.

8 During the liability period, Appellant was a
9 retailer doing business in California and made retail
10 sales and leases of prescription pos-rehabilitation and
11 orthopedic equipment and prosthetic devices, including the
12 following items of TPP at issue in this case: Pneumatic
13 compression devices, heat and cold therapy units, and
14 electrodes, which collectively we will refer to as "The
15 items at issue." Each of these items consist of a
16 motorized or electronic unit or device, not worn on the
17 body, in addition to tubes, sleeves, wraps, blankets, or
18 pads attached to the body.

19 Appellant claimed nontaxable sales of these items
20 on its sales and use tax returns. The issue is whether
21 the items at issue qualify as medicines for purposes of
22 the exemption. Section 6369, which is interpreted and
23 implemented by Regulation 1591, exempts from sales and use
24 tax the gross receipts from the sale of and the storage,
25 use, or consumption of medicines as defined, if they're

1 dispensed or otherwise provided to the patient under
2 certain specified circumstances.

3 Section 6369(a) and Regulation 1591(d), for
4 purposes of the exemption, medicine is defined by
5 Regulation 1591(a) (9) and Section 6369(b) as any substance
6 or preparation intended for use by external or internal
7 application to the human body and a diagnoses, cure,
8 mitigation, treatment, or prevention of disease, and
9 commonly recognized as the substance or preparation
10 intended for that use; or any product fully implanted or
11 injected in the human body or any drug or any biologic
12 when such are approved by the United States Food and Drug
13 Administration to cure or diagnose -- oh, to diagnose,
14 cure, mitigate, treat, or prevent any disease, illness, or
15 medical condition regardless of ultimate use.

16 Regulation 1591(a) (9) (a) through (b) and
17 Section 6369(b), furthermore, Section 6369(b), excludes
18 from the definition of medicines articles that are in the
19 nature of splints, bandages, pad, compresses, supports,
20 dressings, instruments, apparatus, contrivances,
21 appliances, devices, or other mechanical electronic
22 optical or physical equipment or article or the component
23 parts and accessories therefore. See also Regulation
24 1591(c) (2) .

25 In fact, for over 30 years, it has been the

1 Department's position that compression and hot cold
2 therapeutic products, like those at issue in this case,
3 despite being used by doctors for treatment of the human
4 body, are not medicines for purposes of Section 6369(a).
5 I'm going to list a bunch of annotation numbers for you.
6 Please bear with me. See annotations 425.0022.700,
7 425.0170, 425.0292, 425.0293, 425.0512, 425.0883.200, and
8 425.1000. Most of those annotations are from the 80s and
9 90s.

10 Appellant argues that the treatment provided by
11 the items at issue -- Appellant argued in its brief that
12 the provided by the items at issue are, quote, "More of an
13 event an than an object or device," end quote.

14 However, it is not the treatment that is taxable.
15 It is the sale of TPP. Appellant is not providing a
16 service. Appellant is selling and leasing TPP. For its
17 sales and leases to be exempt under Section 6369, the
18 items must be considered a medicine as defined. And as
19 stated previously, Section 6369(b) excludes from the
20 definition of medicines, devices, like those sold by
21 Appellant.

22 Appellant argues that the items at issue are a,
23 quote, "Item preparation treatment," end quote.

24 Distinguishable from the appliances, devices, and
25 equipment specifically excluded from the definition of

1 medicine. Regulation 1591(a)(9)(b) defines medicine as
2 commonly recognized substance or preparation intended for
3 use by external or internal application to the human body.
4 And we've already heard this, but I'm going to state it
5 again. Regulation 1591(b)(1) describes preparations and
6 similar substances to include drugs, such as penicillin
7 and other antibiotics, 70 percent solution alcohol and
8 isopropyl, aspirin, baby lotion, oil, and powder, enemas,
9 hydrogen peroxide, lubricating jelly, medicated skin
10 creams, oral contraceptives, vaccines, topical creams, and
11 ointments, and sterile nonpyrogenic distilled water.

12 When compared to the items on this list, the
13 items at issue are not remotely similar to commonly
14 recognized substances or preparations but are, as
15 categorized by the manufacturer, more in the vein of a
16 device, which is specifically excluded from the definition
17 of medicine. See exhibit G, pages 5, 7, 10, 12, 14, 20,
18 and 24. Historically, the Department has considered items
19 made of durable components and/or which do not depend on
20 being metabolized within the body to achieve their
21 intended purposes, not to be substances or preparations
22 for the purposes of Regulation 1591(a)(9)(b), but rather
23 devices or appliances within the meaning of Section
24 6369(b)(2). See annotation 425.0481, which is dated
25 January 11th, 1993.

1 In its latest brief, Appellant references a,
2 quote, "Retail sales exemption," end quote, which
3 Appellant does not define, explain, or cite to any
4 regulatory or statutory basis for. Appellant seems to
5 argue that its sales of the items at issue are not retail
6 sales because they are, quote, "Not sold to the wanting
7 public," end quote, and requires a doctor's prescription.

8 A retail sale is defined by statute as a sale of
9 TPP for a purpose other than resale in the regular course
10 of business, Section 6007(a)(1). It does not require that
11 any person must be able to purchase the TPP at any time
12 for any reason. Appellant is in the business of selling
13 and leasing prescription post-rehabilitation and
14 orthopedic equipment and prosthetic devices, making it
15 sales of the items at issue the sales of TPP in the
16 regular course of business. Appellant has not claimed
17 that its sale were for resale. Thus, Appellant's sales
18 meet the definition of retail sales. Furthermore, medical
19 equipment prescribed or ordered by a physician may still
20 be excluded from the definition of medicine. See
21 annotations 425.0172, 425.0750, and 425.0827.

22 Appellant also claims that Medi-Cal and private
23 insurance would not pay for the items at issue unless they
24 were considered a medicine, seeming to suggest that if the
25 items at issue were covered by insurance, they must be

1 considered a medicine. However, for the purposes of the
2 exemption, medicine is not defined by what insurance will
3 or will not cover. Rather, medicine is specifically
4 defined by Section 6369 and Regulation 1591. Even if
5 sales of TPP occur for which payment is made under
6 Medi-Cal or private health insurance companies, those
7 sales are subject to tax unless specifically exempt. See
8 annotation 425.0055.

9 To summarize, the items at issue sold by
10 Appellant do not meet the definition of medicines under
11 Section 6369. Therefore, Appellant is liable for
12 additional tax on the disallowed claimed nontaxable sales.
13 Since Appellant has not otherwise disputed the audit
14 methodology or the audited measure, no adjustment to
15 Department's audit determination is warranted.

16 For these reasons, we request the appeal be
17 denied.

18 Thank you.

19 JUDGE ALDRICH: Thank you.

20 At this time, Judge Tay, did you have any
21 questions for either party?

22 JUDGE TAY: I'm going to ask a question of CDTFA
23 quickly. Which is, is it your position that the sales
24 that are taxable include the sale of the VascuTherm's
25 liquid?

1 MS. JACOBS: If the VascuTherm liquid was sold
2 separately, I don't believe that the sale of that liquid
3 was considered taxable. I don't believe that's among the
4 items at issue.

5 JUDGE TAY: Okay.

6 MS. JACOBS: Does that answer your question?

7 JUDGE TAY: I think so. But I'll go back to ask
8 Appellant after their closing.

9 JUDGE ALDRICH: Judge Geary, did you have any
10 questions for either party?

11 JUDGE GEARY: I do not. Thank you.

12 JUDGE ALDRICH: Thank you.

13 So at this time we're going to give Appellant an
14 opportunity to do a closing. You have 5 to 10 minutes.

15 MR. FRISHMAN: Okay. Sure. I'm not thoroughly
16 prepared in closing, but I'll do my best with respect to
17 what she said.

18 What is your name? I'm sorry.

19 JUDGE ALDRICH: That's Ms. Jacobs.

20

21 PRESENTATION

22 MR. FRISHMAN: Ms. Jacobs was all over the place.
23 She begins by talking about orthopedic devices. Again,
24 it's not --

25 JUDGE ALDRICH: Mr. Frishman?

1 MR. FRISHMAN: Mic?

2 JUDGE ALDRICH: Yeah.

3 MR. FRISHMAN: Oh, I'm sorry. Can't hear what
4 was said.

5 Ms. Jacobs was all over the place. She begins by
6 talking about orthopedic devices. It's not an orthopedic
7 device. She talks about annotations, audit methodology.
8 None of that is relevant here today. She -- politely I
9 say she talked about things that are not relevant. So
10 let's focus. Again, let me try to -- and we got off
11 track, I think, a bit too. But let's try to go back.

12 So in summary, the Board's position is it's a
13 prescribed medicine. Dang says so. And all that's left
14 to decide is if it's similar to other items that are tax
15 exempt. While we readily accept that the pneumatic
16 compression and heat and cold therapy units at issue are
17 prescribed by a licensed physician in order to prevent
18 disease or treat disease, the evidence establishes that
19 the items are not similar in formed preparations and other
20 similar substances. But they are.

21 I'm reading from Dang. So he says they are a
22 medicine. He said a lot of things there. He said that
23 they were -- I'm not going to go through the list again.
24 I'm not -- I'm trying not to be repetitive. So are they
25 similar? Well, there are devices that are specifically

1 listed, but this is not one of those orthopedic devices
2 that she refers to broadly. This is medicine, and it
3 administers a treatment. And you have focus on not what
4 it is but what it does. And what it does is cure.

5 And I can't explain very -- I read an
6 explanation. It's very complicated how the subcutaneous
7 activity cures diseases. And Dang says it's a
8 subcutaneous treatment. So none of that. I'm talking
9 about all the things that are not in dispute. We get back
10 to what is in dispute, and that is are they similar to
11 other medical devices.

12 Now, let me reverse that conversely. Is it
13 similar to furniture? Is similar to other items that are
14 typically considered a sales tax assigned?

15 MR. CUMMINGS: Tangible personal property.

16 MR. FRISHMAN: Tangible personal property. Thank
17 you.

18 No. What's it more similar to? More similar to
19 tangible personal property? And that's a hell of a list.
20 Or is it -- you have a wide selection to pick from. It is
21 not related. Is it related to medicine? Oh, yeah, easy.
22 Easy-peasy [sic].

23 I want to go to annotations for a moment. She
24 cites them as her only means to enforce this audit
25 liability. Really, the only means. But let's talk about

1 annotations. I'm not sure the Judges know this, but I
2 want to remind them for the record. An annotation is
3 nothing. Nothing. Almost nothing. So we have statutes.
4 Those are pretty important. You can't deviate. We have
5 regulations. Those are almost as important. You can
6 interpret them broadly. You know what those are better
7 than me. I'm sure. And you have annotations. Nothing.

8 What is an annotation? An annotation is a -- I
9 hate use this word, but I worked at the agency eight
10 years, and I was trained by them. I went into training to
11 scam. Let me say it twice so they don't think it's a
12 mistake. It's a scam. But they're useful sometimes. So
13 sometimes they are. An annotation is not law. It's not
14 enforceable. These are from 1980 and 1990. And I read
15 them, and so did he.

16 MR. CUMMINGS: What we're referring --

17 MR. FRISHMAN: To the annotations.

18 MR. CUMMINGS: -- to other annotations.

19 MR. FRISHMAN: Hold on. Hold me.

20 JUDGE ALDRICH: Excuse me.

21 MR. FRISHMAN: Let me finish.

22 JUDGE ALDRICH: One at a time.

23 MR. CUMMINGS: I'm sorry.

24 MR. FRISHMAN: I'm talking about the topic of
25 annotations, not what's in them. I read them. They are

1 not applicable -- you'll read them -- because they don't
2 talk about medicine. But that's okay. Let's go to
3 annotations and what they are. They -- they are designed
4 by the agency at the lowest level internally to give them
5 some guidance to trap others that are similar. They have
6 a rule. It has to be identical. The facts of the
7 annotation must be identical, not similar, to your facts.
8 How do I know? I've won cases where they are not similar
9 and they cite annotations. It has to be identical.

10 The second component is, they are only guidance.
11 And I'm telling you they are not relevant to whether or
12 not these -- this thing is similar to medicine. So you
13 can't use those guidelines. And the great news is you
14 don't have to. They're not laws. They're not
15 regulations. They're old. They're not relevant. And
16 they are guidelines internally to trap, to victimize
17 taxpayers in liability obligations that may or may not
18 exist based on that annotation. True. But you have to
19 look at them. So I'm going to be very dismissive to this,
20 her citing the annotations over and over again.

21 She can't cite regulation or law. Oh, but she
22 brings them up. So let's talk about those. 6369(b), it
23 is a device.

24 This device here. This is tax exempt, right.

25 MR. CUMMINGS: Yeah.

1 MR. FRISHMAN: Okay. So let's just look at this
2 very practically. This is an item. It's a unit. It's
3 got some cords. It attaches to a body, and it does stuff
4 subcutaneously. It does it on the surface. It does. I
5 looked at this. I know what it is. And it cures things,
6 prevents diseases. It's not taxable according to the
7 Board. That -- it's the same, except it's more complex.

8 It's not yet determined to be nontaxable. That's
9 your job. And it looks different, but it doesn't matter
10 what it looks like because I think I'll end with this
11 point. The statute uses this word preparation and
12 substance. Let's skip over substance for a second,
13 although, there is a similar relationship to the word
14 substance. But let's go to preparation because people
15 casually think preparations are like substances. No.
16 They wouldn't be duplicative. I said that in my opening
17 statement.

18 Preparation is an item, a device, and that's what
19 this is. It's a square peg in a square hole. And in all
20 honesty, I don't think it's debatable. I think it's
21 obvious. I think the Board has gotten sidetracked on all
22 of these peripheral arguments and are resting themselves
23 on these guidances that are not applicable to medicines or
24 orthopedic devices. They are. And they're old. So I
25 think you guys should not put this in the category of

1 tangible personal property. It's certainly not similar to
2 that. It's a medical device.

3 MR. CUMMINGS: And I have one very quick thing.

4 There is a focus that many of you have had over
5 the solution. And my feeling, what you're getting at, is
6 that, oh, this looks like it's -- should be tax free.
7 It's specifically listed. Maybe that should be taxable.
8 But let me tell you where I believe these things are
9 similar to this. This is an enema. This holds liquid.
10 They don't separate this device unit, whatever, from the
11 liquid and say the liquid is nontaxable, but what's
12 holding it is taxable. It's all part of the one unit.
13 It's dispensing liquid.

14 MR. FRISHMAN: Very good point.

15 MR. CUMMINGS: Same thing with aspirin. Do they
16 say, oh, well this bottle that's holding it -- holding the
17 aspirin, that should be taxable because it's not medicine.
18 Or the baby powder or the baby lotion. No. This like
19 this, this tangible thing -- it's not a tangible
20 product -- is holding the liquid. This holds the liquid.
21 So the entire thing here is nontaxable, and that's what
22 we're saying here. And my last --

23 MR. FRISHMAN: Can I make one interpretation?
24 I'm sorry. We're informal here.

25 This aspirin with a prescription -- I know I got

1 a prescription. Same prescription, same mag -- whatever
2 it is -- it's not taxable with a prescription. So all
3 that negates this tax is a prescription. We have several
4 levels of things we presented to you way beyond
5 prescription that negates this from the tax. That's all.

6 MR. CUMMINGS: No, that's all fine.

7 And the only last thing was this aspect that if
8 you want to call this a listed device and you want to put
9 it into the prosthetic device category, then if you do --

10 MR. FRISHMAN: It cannot.

11 MR. CUMMINGS: I know. But if they do, what is
12 specifically said regarding this device is that it does
13 not qualify as a medicine if it's used to treat male
14 impotency. Which means if it's used to treat anything
15 else, it's nontaxable, and it's a medicine.

16 All right. I think that's it.

17 MR. FRISHMAN: We rest our case. I always wanted
18 to say that.

19 JUDGE ALDRICH: Thank you.

20 Before we conclude, I did have one clarifying
21 question. At the beginning of Mr. Frishman's
22 presentation, you indicated that you had an objection.
23 And I just wanted to clarify to what that objection. The
24 objection was to my ruling on the subpoena request.

25 MR. FRISHMAN: Yes, sir.

1 JUDGE ALDRICH: Okay. So I may -- I'll take
2 under submission and address that in the written opinion.

3 MR. FRISHMAN: Thank you.

4 JUDGE ALDRICH: So at this time I'd like to thank
5 everyone for their time. We're ready to conclude the
6 hearing. And the panel will meet and decide the case
7 based off the admitted evidence, the arguments presented
8 today, and we'll send both parties our written decision no
9 later than 100 days.

10 The hearing has adjourned for today, and please
11 cut the live stream.

12 (Proceedings adjourned at 3:39 p.m.)

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

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

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

I have hereunto subscribed my name this 12th day of October, 2023.

ERNALYN M. ALONZO
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