

**OFFICE OF TAX APPEALS**  
**STATE OF CALIFORNIA**

In the Matter of the Appeal of: )  
CSI ALISO, INC. ) OTA Case No. 18032469  
) CDTFA Case ID 577109  
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**OPINION**

Representing the Parties:

For Appellant: Joseph A. Vinatieri, Esq.  
Patricia Verdugo, Esq.

For Respondent: Jarrett Noble, Tax Counsel IV  
Scott Claremon, Tax Counsel IV  
Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Corin Saxton, Tax Counsel IV

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, CSI Aliso, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA),<sup>1</sup> denying, in part, appellant’s petition for redetermination of a Notice of Determination (NOD) dated July 7, 2011. The NOD is for \$882,870.15 in tax, plus applicable interest, for the period January 1, 2007, through December 31, 2009.

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, Josh Aldrich, and Suzanne B. Brown held an oral hearing for this matter in Sacramento, California, on September 20, 2022. At the conclusion of the hearing, the record was closed, and this matter was submitted for an opinion.

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<sup>1</sup> Sales and use taxes were formerly administered by the State Board of Equalization (board). In 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, “CDTFA” shall refer to the board.

### ISSUES

1. Whether appellant sold machinery and equipment to Big West of California, LLC (Big West).<sup>2</sup>
2. Whether appellant timely accepted a valid resale certificate in good faith.<sup>3</sup>
3. Whether CDTFA is estopped from questioning appellant's good faith acceptance of the resale certificate.
4. Whether a portion of California Code of Regulations, title 18, (Regulation) section 1521 is invalid on the basis that it conflicts with R&TC section 6092.
5. Whether there are errors in the audit calculations.

### FACTUAL FINDINGS

1. Appellant, a California corporation, designed, engineered, manufactured, furnished, and in some instances installed emission control systems.
2. Big West operates its Flying J oil refinery in the San Joaquin Valley.
3. By 2006, the San Joaquin Valley Unified Air Pollution Control District adopted certain new emissions requirements with an effective date of June 1, 2007. It is undisputed that Big West was required to reduce nitrogen oxide (NOx) emissions from at least four furnaces and boilers at its Flying J oil refinery because of these requirements.
4. Big West and appellant entered into a Master Services Agreement (MSA) dated March 24, 2006.<sup>4</sup>

#### The March 24, 2006 MSA (Exhibit 10)

5. The MSA identifies Big West as the owner of a refinery and appellant as the person agreeing to perform work (specified under the "scope of work" provisions) for Big West.

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<sup>2</sup> This was identified as issue 4 during the oral hearing and phrased as "whether appellant made nontaxable sales for resale of machinery and equipment." For ease of analysis, this issue is discussed first and was slightly rephrased.

<sup>3</sup> Issues 3, 4, and 5 are moot to the extent that OTA determines that appellant timely accepted a valid resale certificate in good faith.

<sup>4</sup> The MSA is between Applied Utility Systems, Inc. (AUS) and Big West. AUS was a wholly owned subsidiary of Catalytic Solutions Inc. During October 2009, AUS was renamed CSI Aliso, Inc. For ease of analysis, this Opinion refers to AUS and CSI Aliso, Inc. both as "appellant" because these terms now refer to the same entity.

6. The MSA states that its term lasts until the earlier of March 24, 2006, or until all work is completed, or until such date as agreed by the parties in an addendum to the MSA.
7. The MSA states that the scope of work is all work described in Exhibit A to the MSA. Exhibit A to the MSA is a blank purchase order that must be completed and submitted from Big West to appellant. The blank purchase order states “Good or services authorized by this Purchase Order must be described in detail in a Scope of Work attached hereto.” The MSA did not otherwise specifically describe or detail any specific work ordered as of the MSA date (March 24, 2006).
8. The evidentiary record does not include any purchase orders issued pursuant to the MSA, or pursuant to any addendum thereto. The evidentiary record also does not include any purchase order attachments titled Scope of Work.
9. The MSA provided that Big West may at any time order extra work, alterations, additions to or deductions from the work in the form of change orders, which must be in writing and signed by both parties.
10. The evidentiary record does not include any change orders.

The June 12, 2006 proposed revision to the MSA (Exhibit 11)

11. By letter dated June 12, 2006, appellant provided a “revised proposal for this project” to Big West (revised proposal). The revised proposal was transmitted via email and is not signed by Big West.
12. The revised proposal includes pertinent background information for the project. According to the revised proposal, Big West’s Flying J oil refinery is located in the San Joaquin Valley and was required by the local Air Pollution Control District to reduce NOx emissions from four furnaces and boilers identified in Table 1 to the proposal as follows: (1) Hydrogen Reformer; (2) Boiler 9; (3) Crude Heater; and (4) Coker H-100.
13. The deadline for Big West to comply with the emissions requirements was June 1, 2007. Big West intended to hire appellant to install selective catalytic reduction (SCR) systems on the furnaces and boilers to satisfy these requirements. Big West wanted to ensure that “tie-in” of the SCR systems to the furnaces and boilers caused minimal outage time for the Flying J oil refinery.

14. The projected timeframe to perform the work was September 2006 through May 2007. The general work description includes construction of the systems, fabrication, commissioning equipment in all areas, start-up, and compliance testing.
15. The June 12, 2006, revised proposal states that a “description of [appellant’s] scope of work is provided in Table 3.” It also states “Items not listed in Table 3 as part of [appellant’s] scope of work will not be furnished by [appellant.]” The scope of work specifies, in pertinent part, that the following work will be performed by appellant:
- Installation of [appellant] supplied equipment including supervision, safety, QA/QC.
- Furnish and install concrete slab foundations and anchor bolts.
  - Install SCR systems and equipment.
  - Furnish and install electrical and control system.
  - Furnish and install piping system.
  - Furnish and install thermal insulation.
- ¶ . . . ¶
- The installation is based on normal working hours; 8 hours/day, 5 days/week.
  - Ammonia piping will be 304 stainless steel.
  - Removal of any asbestos, lead or other existing hazardous materials encountered will be the responsibility of [Big West].
  - The costs for materials and labor for the tie-ins [of the SCR systems to the furnaces and boilers] required during the October, 2006, shutdown [of the refinery] have not been included.
16. Table 4 of the revised proposal includes a detailed breakdown of appellant’s bid prices for furnishing and installing the SCR systems. The revised proposal is identified as a lump sum fixed price contract to be finalized by August 31, 2006, and the total bid price, including options, is \$6,938,000 (\$5,450,000 base price, plus \$1,488,000 in options).
17. The base project bid price proposed by appellant for the contract is \$5,450,000. The project bid price is broken down as follows: (1) equipment (including fabrication, engineering, and design), \$4,150,000; (2) installation of the equipment, \$1,300,000.
18. The total project bid price for additional options (in addition to the base bid price) is \$1,488,000. The project bid price for options is broken down as follows: (1) equipment, \$952,000; and (2) installation of the equipment, \$536,000.

19. The revised proposal is titled “20987.99 Revision 2.” There is no “Revision 1” of this document contained in the written record.<sup>5</sup>
20. It is not clear from the written documentation whether Big West accepted the revised proposal or made a counter proposal. The revised proposal does state, however, that Big West already provided “confirmation of acceptance of our proposal” via email sent June 8, 2006, indicating that it was appellant’s understanding that Big West agreed to the revised proposal. The referenced email is not in the evidentiary record.
21. It appears undisputed that the June 12, 2006, revised proposal substantially or fully represents the agreement between the parties as of that date. Appellant provided no documentation, evidence, or argument that there were any addendums or changes to the June 12, 2006 revised proposal prior to October 31, 2006, when Big West issued a resale certificate to appellant.

The October 31, 2006 Resale Certificate (Exhibit 4)

22. On October 31, 2006, appellant accepted a “Uniform Sales & Use Tax Certificate – Multi-Jurisdictional” from Big West. The resale certificate is dated October 31, 2006, and there is a fax timestamp dated October 31, 2006.
23. Big West’s resale certificate includes the following statement:

I certify that: Big West of California LLC [address omitted] is engaged as a registered retailer and is registered with the listed states within which your firm would deliver purchases to us and that any such purchases are for resale in the normal course of our business. We are in the business of retailing the following: PETROLEUM PRODUCTS, CONVENIENCE STORE MERCHANDISE, AND RESTAURANT FOOD.

[California seller’s permit and prepaid sales tax account number omitted.]

¶ . . . ¶ This certificate shall be part of each order and shall be valid until cancelled by us in writing or revoked by the state.

General description of the products to be purchased from the seller:  
Emission Control Equipment & Services.

24. Big West’s procurement manager signed the resale certificate under penalty of perjury.

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<sup>5</sup> The title “20987.99, Revision 2” appears directly below the subject line, indicating that there is an original and a first revision; however, this is the only revision in the evidentiary record. There is a February 9, 2007 addendum to the MSA titled Project No.: 20987, Revision No. 1; however, it is dated after the June 12, 2006 revised proposal titled 20987.99 Revision 2.

25. During October 2006, David Gubser, appellant's witness, took on the role of Project Manager for appellant. Mr. Gubser was in charge of implementing the SCR systems at Big West's Flying J oil refinery during 2006 and 2007. He testified during the hearing that he was not aware whether appellant questioned Big West on the resale certificate aspect, and that the resale aspect was not discussed to his knowledge.

The draft letter dated January 30, 2007 (Exhibits 12 and 22)

26. A letter dated January 30, 2007, printed in Microsoft Word Track Changes mode with tracking enabled, written by appellant's Project Manager and addressed to Big West, is attached as Attachment 2 to a February 9, 2007 addendum to the MSA.
27. The January 30, 2007, draft letter states that it summarizes discussions from January 29, 2007, and February 6, 2007, and amends a letter dated January 30, 2007.<sup>6</sup>
28. The draft letter includes the following payment terms: (1) Phase 1 construction in the amount of \$1,289,800; (2) Phase 2 construction management costs in the amount of \$1,585,300; (3) Phase 2 construction costs in the amount of \$3,536,290.
29. The draft letter includes a schedule of values for Phase 1 construction, in the amount of \$1,289,300. This schedule is mostly illegible. There are five columns which appear to be dates. While the dates are not legible, the period covered by this schedule appears to be January through March 2007, and several of the rows appear to call for the "Delivery" of something within this timeframe.
30. The draft letter also includes a schedule of values for Phase 2 construction, including a further breakdown of costs: (1) Phase 2 construction management costs of \$1,585,300; (2) mechanical subcontracting costs of \$2,240,745; (3) electrical subcontracting costs of \$771,650; (4) contingency costs of \$523,895. The total Phase 2 construction cost is \$5,121,590. The draft letter also provides that Big West will issue Service Orders covering the above work. There are no Service Orders in the evidentiary record.
31. The draft letter also provided that: (1) Big West will submit an amended purchase order for equipment and engineering cost, in the amount of \$4,895,420 (this purchase order is not a part of the evidentiary record); (2) Big West will hire appellant to supply a low NOx burner for Boiler 9 (a written proposal or service agreement covering this

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<sup>6</sup> It appears that the track changes are the February 6, 2007, revisions to a prior letter dated January 30, 2007 (which is not in the record), and that the date was not updated.

transaction is not a part of the evidentiary record); (3) all construction and cold commissioning work will be completed by May 23, 2007.

The February 9, 2007 addendum to the MSA (Exhibit 12)

32. Appellant submitted selected portions of a February 9, 2007 addendum to the MSA. The addendum provides that Big West shall pay appellant for the work described in Attachment 1, pursuant to the amounts specified in Attachment 2. The addendum also specifies that appellant will subcontract the civil/mechanical and electrical work to qualified subcontractors.
33. Attachment 1 includes a document titled “Civil/Mechanical Installation Services – Specification No. 20987-SP-134.” This document is not a part of the evidentiary record. Attachment 1 also includes a document titled “Electrical Installation – Specification No. 20987-SP-133,” which is a part of the evidentiary record.
34. Attachment 2 includes the draft letter dated January 30, 2007 (summarized above).
35. Attachment 3 is a “Project Schedule.” This document is not legible.
36. Both parties signed the addendum on February 28, 2007.<sup>7</sup>

Electrical and Civil/Mechanical subcontracts (Exhibits 14 and 15)

37. Appellant provided a copy of the subcontract between appellant and Adamson Electric, Inc, to perform the electrical work. Appellant also provided a copy of the subcontract between appellant and Total-Western, Inc., for the civil/mechanical work. Both subcontracts start off with a preamble stating: “Whereas, on or about March 24, 2006, [Appellant] entered into a Master Services Agreement (the ‘Prime Contract’) with Big West of California (‘Owner’) for SCR Flying J Refinery.”
38. There are no additional contemporaneous written contract agreements in the evidentiary record, aside from billing invoices issued from appellant to Big West.

The available invoices (Exhibit 21)

39. Appellant provided 15 out of what appears to be a total of 63 invoices issued from appellant to Big West for various work performed by appellant. The invoices are each one page in length and are summarized as follows:

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<sup>7</sup> Appellant also provided an “Installation Schedule” (Exhibit 13), which is not legible.

- a. Invoice 14, dated January 12, 2007. This invoice is for two parts: “Engineering and Equipment” (part 1) \$1,522,000, and “Phase 1 Construction” (part 2) \$395,600. For part 1, the engineering amount is \$140,000, and the balance of the charge is for equipment. For part 2, Construction includes the cost of building permits, \$13,000; labor performed in December, \$40,600; a “Unit 10-H1,” \$162,000; and materials cost, \$191,000.
- b. Invoice 15, dated February 1, 2007. This invoice is for “Engineering and Equipment,” \$598,500, and “Phase 1 Construction,” \$384,000. For part 1, the engineering amount is \$55,000, and the balance of the charge is equipment. For part 2, construction includes delivery of structural steel, \$100,000; fabrication of structural steel, \$30,000; and fabrication of ducting, \$254,000.
- c. Invoice 16, dated February 15, 2007. This invoice is for “Engineering and Equipment,” \$314,500; “Phase 1 Construction,” \$110,000; and “Phase 2 Construction” (part 3). For part 1, the engineering amount is \$10,000, and the balance of the charge is equipment. For part 2, construction includes fabrication of structural steel, \$110,000. For part 3, the charges are for cost of construction management, \$198,163, and subcontractor cost, \$224,250.
- d. The remaining invoices, invoices #18, 19, 21, 24, 26, 27, 28, 31, and 36, follow the same format as the prior invoices. The total subcontractor charge for all invoices (including invoice 16) is \$2,972,395, and the total construction management charge is \$1,585,304.
- e. Invoice 38, dated July 12, 2007. The cost of construction management (part 2) included a “retention on progress payments” amount equal to 10 percent of the invoiced construction management (i.e., progress payment) amounts.<sup>8</sup> Invoice 38 itemized the total retention on progress payment amounts from the above invoices as \$158,530.40.<sup>9</sup> The cost of subcontractors also included a “retention on

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<sup>8</sup> The facts indicate that the construction management payments were milestone payments (progress payments) and the 10 percent retention amounts were amounts entitled to be withheld from appellant by Big West until practical completion of the work to ensure satisfactory work.

<sup>9</sup> The construction management payments were all for \$198,163.00. Ten percent of this amount is \$19,816.30. There were 8 progress payments in the above invoices, so the total is the multiple of \$19,816.30 x 8 payments.



progress payments” amount equal to 10 percent of the invoiced subcontractor cost. Invoice 38 itemized the total retention amounts on subcontractor costs as \$297,239.50. The total retention payments were due “Net 30 days” from the invoice date of July 12, 2007.

- f. Invoice 40, dated July 18, 2007. This invoice charges for a change order, for a compatibility upgrade, repair, and recoupling, totaling \$107,320.
- g. Invoice 63, dated December 31, 2007. This is titled “final billing,” and includes “Equipment Contract,” \$20,090, and “Construction Contract,” \$1,431,102.30.

Additional background facts

- 40. Appellant constructed, furnished, and installed the SCR systems for Big West. Appellant did not collect any sales tax reimbursement from Big West in connection with the construction, furnishing, or installation of the SCR systems. Appellant also did not report or pay sales tax to CDTFA for these transactions.
- 41. Upon audit, CDTFA reviewed pictures and a schematic diagram of the SCR systems and determined that the SCR systems were either attached to the oil refinery or mounted on a concrete platform attached to the oil refinery. Furthermore, CDTFA determined that the SCR systems are essential to the oil refinery because, although the oil refinery could operate without the SCR systems, it would be unable to meet the pollution standards without the SCR systems. CDTFA also determined that removal of the SCR systems would require extensive labor and cost. Based on the above, CDTFA concluded that the SCR systems constitute fixtures, which appellant installed pursuant to a construction contract. CDTFA determined that the resale certificate appellant obtained from Big West did not relieve appellant of its sales tax liability.
- 42. CDTFA reviewed appellant’s sales journal and sales invoices to Big West to establish a deficiency measure for disallowed claimed nontaxable sales for resale of \$12,168,819, established on an actual basis (audit item 1).
- 43. The audit also disclosed \$8,139 in unreported purchases of fixed assets subject to use tax, which appellant does not dispute (audit item 2).
- 44. CDTFA issued an audit report on November 5, 2010, disclosing the above liability.

45. CDTFA issued an NOD on July 7, 2011, for \$882,870.15 in tax, and applicable interest, for the liability disclosed by audit.<sup>10</sup> Appellant petitioned the NOD.
46. On July 21, 2014, CDTFA issued a decision partly denying the petition. CDTFA's decision allowed a \$3,184,308 reduction to audit item 1 for the work performed by subcontractors: \$2,220,745 for subcontract work performed by Total-Western, Inc. and \$963,563 for subcontract work performed by Adamson Electric, Inc. This reduced the unreported measure for both audit items from \$12,176,958, to \$8,992,650. CDTFA otherwise denied the petition.
47. This timely appeal to OTA followed.<sup>11</sup>

### DISCUSSION

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) The law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.) It is the retailer's responsibility to maintain complete and accurate records to verify the accuracy of any return made and to make them available to CDTFA for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Ibid.*) It is appellant's burden to establish that the circumstances it asserts are more likely than not to be correct. (*Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (*Ibid.*)

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<sup>10</sup> The NOD was timely because appellant signed a waiver of the statute of limitations.

<sup>11</sup> Appellant requested an oral hearing before the board. This matter was subsequently transferred to OTA before the matter was heard by the board.

Issue 1: Whether appellant sold machinery and equipment to Big West.

As a preliminary matter, appellant argues that there were two separate transactions: (1) a contract for the design and sale of the SCR systems, which are machinery and equipment; and (2) a separate contract to furnish and install the SCR systems. In support, appellant cites to the MSA (dated March 24, 2006) as the first contract, and the addendum (dated February 9, 2007) as the second contract. Appellant contends that, at a minimum, it accepted a resale certificate in good faith because at the time it accepted the October 31, 2006 resale certificate, it was operating under the first contract to design and sell (but not install) the SCR systems. Therefore, the first line of inquiry is whether appellant was responsible for installing the SCR systems when it accepted the resale certificate, and the second line of inquiry is whether the transaction or transactions involved the sale of machinery and equipment (tangible personal property) or a construction contract to furnish and install materials and fixtures on or to realty.

Appellant's scope of work under the contract with Big West

In the instant case, the available documentation is incomplete and insufficient to draw a complete timeline of events. While it is clear the parties entered into the MSA on March 24, 2006, appellant failed to provide any documentation regarding the scope of work or any purchase order detailing the work to be performed pursuant to the initial March 24, 2006 MSA. The only purchase order in the evidentiary record is a blank purchase order with no information completed. Thus, because appellant failed to provide complete documentation, there is insufficient evidence of appellant's scope of work under the agreement during the period March 24, 2006, until June 12, 2006. Nevertheless, because the resale certificate was not accepted until October 31, 2006, the pertinent inquiry is the scope of work when appellant accepted the resale certificate.

There is no contemporaneous written documentation to support appellant's contention that, at the time it accepted the resale certificate on October 31, 2006, appellant was not responsible for installing the SCR systems. To the contrary, the available documentation establishes that by June 12, 2006, pursuant to the proposed revision to the MSA, appellant was required to install the following items on Big West's Flying J oil refinery: the concrete slab foundations and anchors, the SCR systems and equipment, the electrical and control system, the

pipng system, and the thermal insulation. It is also undisputed that appellant did in fact furnish and install the SCR systems.

In summary, appellant’s own Exhibit 12, the June 12, 2006 revised proposal, specifies that appellant’s scope of work requires appellant to “Install SCR systems and equipment.” Thus, the available evidence establishes that by no later than June 12, 2006, and including when appellant accepted the resale certificate from Big West, and at all relevant times thereafter, it was agreed between the parties that appellant was ultimately responsible for installing the SCR systems.

#### Sale of machinery and equipment versus a construction contract

Here, appellant contends that it was selling machinery and equipment, as opposed to furnishing and installing materials and fixtures under a construction contract.

A construction contractor includes any person who for themselves, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. (Cal. Code Regs., tit. 18, § 1521(a)(2).)

A construction contract includes, in pertinent part, a contract, whether on a lump sum, time and material, cost plus, or other basis, to erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property, including refineries, and systems for the transmission of petroleum and other liquid or gaseous substances. (Cal. Code Regs., tit. 18, § 1521(a)(1)(A)1-2.)

A construction contract does not include a “contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment”. (Cal. Code Regs., tit. 18, § 1521(a)(1)(B).) In addition, a contract to design, develop, and manufacture custom-made property is a sale of tangible personal property, and the measure of tax includes all charges related to research, design, and development activities. (Cal. Code Regs., tit. 18, § 1501.1(b)(3).) No deduction from the measure of tax is allowed for labor or service cost, the cost of materials used, interest paid, losses, or any other expense. (R&TC, § 6012(a)(2).) As an exception, the measure of tax does not include charges for installation labor. (R&TC, § 6012(c)(3).)

In the context of a construction contract, Regulation section 1521 further interprets and implements these statutory provisions, and the California courts have upheld the validity of this regulation. (See *Honeywell, Inc. v. State Bd. of Equalization* (1975) 48 Cal.App.3d 897.) For these purposes, Regulation section 1521 classifies property furnished under a construction

contract into three categories: materials, fixtures, and machinery and equipment. (Cal. Code Regs., tit. 18, § 1521(a)(4)-(6).)

A construction contractor is the consumer of materials, and retailer of fixtures, and machinery and equipment, which they furnish and install in the performance of a construction contract and tax applies to the construction contractor's gross receipts from such sales. (Cal. Code Regs., tit. 18, § 1521(b)(2).) Generally, the construction contractor's measure of tax will include any amount specifically charged for fixtures, or machinery and equipment, in the construction contract. (See Cal. Code Regs., tit. 18, § 1521(b)(2)(B)2, (b)(2)(C)1.) When the construction contract is on a lump sum basis, the construction contractor is the manufacturer, and there is no separately stated or readily ascertainable retail market price for the fixture or machinery and equipment, then the construction contractor's gross receipts (also referred to as cost price) may be determined based on price lists, bid sheets, or other records of the contractor. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)-(C).)

Fixtures means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. (Cal. Code Regs., tit. 18, § 1521(a)(5).) Materials means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. (Cal. Code Regs., tit. 18, § 1521(a)(4).) Appendix A to Regulation section 1521 provides a list of items regarded as materials, which includes items such as asphalt, plaster, builder's hardware, steel, sheetmetal, cement, conduit, ducts, connections, piping, valves, pipes, fittings, insulation, caulking materials, and electrical wiring.

The term machinery and equipment means and includes property intended to be used in the production, manufacturing, or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached is readily removable without damage to the unit or realty. (Cal. Code Regs., tit. 18, § 1521(a)(6).)

Fixed works includes refineries and systems for the transmission of petroleum and other liquid or gaseous substances. (Cal. Code Regs., tit. 18, § 1521(a)(1)(A)2.)

While a construction contractor cannot avoid sales or use tax by taking a resale certificate for materials or fixtures that they furnish and install, Regulation section 1521 does not specifically prohibit a construction contractor from taking a resale certificate for sales of machinery and equipment that they install. (Cal. Code Regs., tit. 18, § 1521(b)(6)(A).)

Here, the first thing to consider is the scope of work provisions in the agreement between the parties. The June 12, 2006 revised proposal provides that appellant was responsible for furnishing and installing concrete slab foundations, anchor bolts, the electrical system, the piping system, and the thermal insulation. These items are all regarded as materials. (Cal. Code Regs., tit. 18, § 1521, Appendix A.) The costs for electrical installation alone, which appellant subcontracted out in whole or part, represented no less than \$771,650 of the total contract charge.

Next, the SCR systems were delivered, in pieces, to the Flying J oil refinery and affixed to the realty from the ground up, and were anchored in place on concrete foundations that appellant was responsible for furnishing and installing. The nature of attachment to the realty was significant. It included the concrete foundations, substantial electrical connections, substantial ducting, steel connectors, physical anchoring, obtaining building permits, and required shutting down the furnaces and boilers to “tie-in” the SCR systems. It took approximately nine months (September 2006 until May 2007) to furnish and install the SCR systems. The revised proposal states that the Flying J oil refinery would be shut down during October 2006 for the tie-in of the SCR systems to the furnaces and boilers, and projected that construction would continue until May 2007. Thus, the evidence indicates that the parties believed installation of the SCR systems would take eight months. This substantial time commitment, in addition to the other facts and circumstances noted above, is evidence that the nature of attachment to the realty was not incidental. In addition, the components to the SCR systems weigh between three and five tons,<sup>12</sup> and removal of these components would require a substantial time commitment, specialized equipment, and labor. According to appellant, removal requires a mobile crane and would take three to four weeks to complete. Under these facts, the

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<sup>12</sup> Appellant states that the SCR or CO (carbon monoxide) reactor weighs between four and five tons, the booster fan weighs five tons, the ammonia tank weighs three to four tons, and the largest segment of the flue gas ducting weighs four to five tons.

SCR systems (and materials and other components installed in the furnishing thereof) are not incidentally attached to the realty, and they are not readily removable from the realty. As such, they are not machinery and equipment.

Based on all the above, the evidence establishes that appellant was responsible for furnishing and installing, and did in fact furnish and install, materials and fixtures for Big West. As such, this Opinion finds that no later than June 12, 2006, and including when appellant accepted the resale certificate from Big West, and at all relevant times thereafter, appellant was a construction contractor performing a construction contract. Furthermore, the evidence does not support appellant's contention that it merely sold machinery and equipment to Big West.

Issue 2: Whether appellant timely accepted a valid resale certificate in good faith.

The next question is whether appellant, as a construction contractor, could accept a resale certificate in good faith with respect to the materials and fixtures that it was responsible for furnishing and installing under the construction contract.

The resale certificate

A retail sale means a sale for any purpose other than resale in the regular course of business. (R&TC, § 6007.) In other words, sales for purposes of resale are excluded from the measure of tax. (R&TC, § 6012; Cal. Code Regs., tit. 18, § 1668(e).) The burden of proving that a sale of tangible personal property is not at retail is upon the retailer unless the retailer timely and in good faith takes a certificate from the purchaser stating that the property is purchased for resale (resale certificate). (R&TC, §§ 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).) If timely taken in proper form and in good faith from a person who is engaged in the business of selling tangible personal property and who holds a California seller's permit, the resale certificate relieves the seller from liability for the sales tax and the duty of collecting the use tax. (Cal. Code Regs., tit. 18, § 1668(a).) Regulation section 1668 specifies the required form, including all essential elements, of a resale certificate, and the timeframe in which it must be accepted to be timely. (See Cal. Code Regs., tit. 18, § 1668(a), (b).)

Here, CDTFA concedes, and appellant agrees, that appellant timely accepted a resale certificate in the proper form, including all essential elements, from Big West. There is no reason to question this agreed item based on the evidentiary record, and this Opinion accepts it as

fact. As such, the dispute for OTA to resolve with respect to the resale certificate is whether appellant accepted it in good faith.

### Good faith

With respect to the requirement of good faith, Regulation section 1668 provides as follows:

(c) Good Faith. In absence of evidence to the contrary, a seller will be presumed to have taken a resale certificate in good faith if the resale certificate contains the essential elements as described in subdivision (b)(1) [of Regulation section 1668] and otherwise appears to be valid on its face. If the purchaser insists that the purchaser is buying for resale property of a kind not normally resold in the purchaser's business, the seller should require a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business.

(Cal. Code Regs., tit. 18, § 1668(c).) In addition, Regulation section 1521 further provides, in pertinent part, a situation involving construction contractors where a resale certificate cannot be used to relieve a person of liability for the tax:

(A) Resale Certificates. Contractors holding valid seller's permits may purchase fixtures and machinery and equipment for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials.

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him or her by taking a resale certificate from the prime contractor, interior decorators, designers, department stores, or others. However, under the circumstances described in subsection (b)(2)(B)3., a contractor may take a resale certificate for fixtures furnished and installed by him or her for a person other than the owner of the realty.

(Cal. Code Regs., tit. 18, § 1521(b)(6)(A) [Emphasis added].) Regulation section 1521 specifically cites to R&TC sections 6091 and 6092 (the authority for resale certificates and the requirement that they be accepted in good faith) as statutory references.<sup>13</sup> A statutory reference “means the statute, court decision, or other provision of law which the agency implements, interprets, or makes specific by adopting . . . a regulation. (Gov. Code, § 11349(e).) In other

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<sup>13</sup> California regulations generally include “authority” cites and “reference” cites. The “authority” refers to the statute(s) or law(s) which delegates rulemaking authority to the agency to adopt, amend, or repeal the regulation at issue, and the “reference” identifies the statute, court decision, or other law being interpreted, implemented, or applied by the regulation. (Gov. Code, § 11349(b), (e).)



words, the applicable regulatory framework explicitly provides that Regulation section 1521 interprets and implements R&TC section 6092, which is the statutory requirement of good faith. Thus, it should be clear that the prohibition in Regulation section 1521(b)(6)(A) against a construction contractor accepting a resale certificate for materials or fixtures that they furnish and install clarifies the good faith requirement of R&TC section 6092, as that requirement is applied to construction contractors.<sup>14</sup>

The good faith requirement pertains to whether the person *accepting* the resale certificate (as opposed to the person furnishing it) acted in good faith. (Cal. Code Regs., tit. 18, § 1668(c).) Thus, it is necessary to determine whether appellant acted in good faith when accepting the resale certificate. Here, appellant, like any other taxpayer, is presumed to know the law. (See *Arthur Andersen, LLP v. Superior Court* (1998) 67 Cal.App.4th 1481, 1506-1507.) The law provides that a construction contractor, such as appellant, cannot accept a resale certificate from Big West for materials and fixtures that appellant furnishes and installs. (Cal. Code Regs., tit. 18, § 1521(b)(6)(A).) First, such a resale certificate would not “appear[ ] valid on its face” due to the fact that it was issued to appellant for furnishing and installing materials and fixtures under a construction contract, which, except in very limited circumstances which are not applicable under the facts of this case, is prohibited under Regulation section 1521.<sup>15</sup> (Cal. Code Regs., tit. 18, § 1668(c).) Furthermore, appellant had been negotiating the construction contract to furnish and install the SCR systems, and entered into the MSA, prior to accepting the resale certificate. Therefore, appellant knew at the time it accepted the resale certificate that it would

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<sup>14</sup> In its Decision, CDTFA initially concluded the good faith element, and the provision of Regulation section 1521(b)(6)(A), were separate and concluded that while there was good faith, the requirements of Regulation section 1521(b)(6)(A) were not met. However, on appeal to OTA, CDTFA has since changed its position and now rejects this prior position in its Decision. Instead, CDTFA now contends that good faith and the provisions of Regulation section 1521(b)(6)(A) are intertwined and, thus, the resale certificates were not accepted in good faith because of the requirement of Regulation section 1521(b)(6)(A). Appellant has not taken a position on this aspect, aside from contending that CDTFA cannot change its position on appeal (discussed as issue 3, below).

<sup>15</sup> A construction contractor may accept a resale certificate from a lessor for leased fixtures that they install for a person, other than the owner of the realty, who intends to lease the fixture in place as tangible personal property as provided in R&TC section 6016.3. (Cal. Code Regs., tit. 18, § 1668(b)(3).) Here, there is no evidence or argument that the property includes any leased fixtures for persons other than the owner of the realty. To the contrary, the MSA identifies Big West as the owner of the oil refinery, and the June 12, 2006 revision to the MSA identifies Big West as the person using the SCR systems. There is no provision which would allow a construction contractor to accept a resale certificate for materials that they furnish and install; however, a construction contractor may be regarded as a retailer and issue a resale certificate for their purchases of materials that they furnish and install if there is a provision passing title prior to installation. (Cal. Code Regs., tit. 18, § 1668(b)(2)(A), (b)(6)(A).)

be furnishing and installing the property covered by the resale certificate as a construction contractor, and this is further “evidence to the contrary” that appellant accepted it in good faith. (Cal. Code Regs., tit. 18, § 1668.)

Consequently, this Opinion finds that, because of the limitations contained in Regulation section 1521(b)(6)(A),<sup>16</sup> appellant did not act in good faith when it accepted a resale certificate for materials and fixtures that it furnished and installed pursuant to a construction contract.

Issue 3: Whether CDTFA is estopped from questioning appellant’s good faith acceptance of the resale certificate.

Here, appellant is asking for relief from the liability on the basis that CDTFA is estopped from disputing that appellant accepted the resale certificate in good faith. CDTFA previously concluded, during the audit and in its decision which was appealed to OTA, that appellant accepted the resale certificate in good faith. Notwithstanding its concession on good faith, CDTFA still asserted that tax applies on the basis that a construction contractor cannot accept a resale certificate from a customer for materials and fixtures that it furnishes and installs. (Cal. Code Regs., tit. 18, § 1521(b)(6)(A).) On appeal to OTA, CDTFA now asserts that appellant, as a construction contractor, could not have accepted the resale certificate in good faith. Under issue 2, above, this Opinion agreed with CDTFA’s current position that appellant did not act in good faith when it accepted the resale certificate for materials and fixtures that it furnished and installed pursuant to a construction contract.

Burden of proof – new matter versus new argument

As a preliminary matter, it is important to clarify here that CDTFA did not raise a new matter, such as would occur if CDTFA changed its position on whether tax applies and asserted an increase. (See *Appeal of Praxair*, 2019-OTA-301P.) Here, CDTFA has always maintained that tax applies. In other words, CDTFA has merely changed its theory for why tax applies, and such a change does not shift the burden of proof in this appeal from appellant to CDTFA. (Cal. Code Regs., tit. 18, § 30219(a); *Appeal of Praxair*, *supra*.)

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<sup>16</sup> Below in issue 4, this Opinion discusses appellant’s contention that Regulation section 1521(b)(6)(A) is in conflict with the provisions of R&TC section 6092.

R&TC section 6596

In effect, appellant asks OTA to grant relief of the tax liability based on the legal arguments and conclusions presented in CDTFA's written decision denying appellant's petition for redetermination. The law only authorizes relief of a sales tax liability under specific and limited circumstances involving reliance on written advice. (R&TC, § 6596.) R&TC section 6596 imposes four requirements for such relief, which are summarized, in pertinent part, as follows. First, the taxpayer must request written advice on the application of tax from CDTFA and the request must set forth the specific facts and circumstances of the activity or transactions for which the advice is requested. (R&TC, § 6596(b)(1).) Second, CDTFA must respond in writing, stating whether or not the described activity or transaction is subject to tax, or stating the conditions under which the activity or transaction is subject to tax. (R&TC, § 6596(b)(2).) Third, the taxpayer must reasonably rely on the written advice. (R&TC, § 6596(b)(3).) Fourth, the liability for taxes must occur before CDTFA rescinds the advice or a change in law renders the advice no longer valid. (R&TC, § 6596(b)(4).) Any person requesting relief of the taxes must file a statement under penalty of perjury setting forth the facts on which a request for relief of the taxes is based. (R&TC, § 6596(c).)

In the instant case, it is undisputed that appellant did not request or obtain written advice from CDTFA prior to accepting the resale certificate from Big West. To the contrary, the alleged reliance first occurred during the audit of appellant over the disputed transactions, years after appellant had failed to charge or collect tax from Big West. As a matter of law, OTA lacks statutory authority under R&TC section 6596 to grant relief of the taxes under these facts.

Equitable estoppel

Although appellant specifically requests relief of the tax liability on an equitable basis, as a general matter equitable powers can only be exercised by a court of general jurisdiction. (See *Standard Oil Co. v. State Bd. of Equalization* (1936) 6 Cal.2d 557, 559.) As an administrative agency, OTA lacks constitutional authority to exercise judicial powers. (Cal. Const., Art. 6, § 1.) Under limited circumstances where doing so is otherwise consistent with the law, a non-constitutional administrative agency may exercise equitable estoppel without violating Article 3, Section 3.5 of the California Constitution, which provides that an administrative agency may not refuse to enforce a statute. (*Lentz v. McMahon* (1989) 49 Cal.3d. 393, 402-403.) Thus, for

example, the California Supreme Court has concluded that a statute authorizing an administrative agency to “fairly and equitably” construe the law conferred authority on that agency to apply the doctrine of equitable estoppel during an administrative hearing. (*Ibid.*)

Here, it would not be consistent with the law to apply equitable estoppel. In lieu of estoppel, the legislature enacted R&TC section 6596. R&TC section 6596 sets forth the only circumstances under which a taxpayer’s detrimental reliance on tax advice from CDTFA may be the basis for relief of taxes. That section specifically requires reasonable reliance on written advice to relieve a tax liability.<sup>17</sup> OTA is an administrative agency, and OTA has no authority under the California Constitution to decline to follow the clear and unambiguous provisions of R&TC section 6596. Thus, equitable estoppel is not available to grant relief for cases where, as here, there was no reasonable reliance on written advice from CDTFA.

Under these facts, applying the doctrine of equitable estoppel to grant relief under circumstances where OTA is explicitly barred by statute from granting such relief would directly contravene the clear language of R&TC section 6596. OTA cannot create an exemption that is not authorized by law. (See *Market Street Railway Co. v. State Bd. of Equalization* (1955) 137 Cal.App.2d 87, 96-97.) As such, this Opinion concludes that under the facts of this case, OTA lacks authority to apply the doctrine of equitable estoppel to grant relief of taxes.<sup>18</sup>

Issue 4: Whether a portion of Regulation section 1521 is invalid on the basis that it conflicts with R&TC section 6092.

The facts pertinent to this issue are undisputed. Regulation section 1521 provides, in pertinent part, as follows:

A contractor cannot avoid liability for sales or use tax on materials or fixtures furnished and installed by him or her by taking a resale certificate from [a customer].

(Cal. Code Regs., tit. 18, § 1521(b)(6)(A).) The pertinent statutory authority provides as follows:

6091. Presumption of taxability; resale certificate. . . The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from the purchaser a [resale certificate.]

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<sup>17</sup> Moreover, relief of tax under R&TC section 6596 requires that, based on reasonable reliance on CDTFA’s written advice, the taxpayer failed to pay use tax or failed to charge or collect tax or tax reimbursement from a customer. (R&TC, § 6596(b)(3).)

<sup>18</sup> Based on the finding that OTA lacks authority under the facts to apply the doctrine of equitable estoppel, this Opinion does not address whether the elements are met.

6092. Effect of certificate. The certificate relieves the seller from liability for sales tax only if taken in good faith from a person who is engaged in the business of selling tangible personal property and who holds [a California seller's permit.]

6093. Form of certificate. [required elements omitted] . . . ¶

CDTFA's decision concluded that appellant timely and in good faith accepted a resale certificate but that tax nevertheless applies because Regulation section 1521 provides that a construction contractor cannot take a resale certificate for materials and fixtures that it furnishes and installs. On appeal, CDTFA maintains that Regulation section 1521(b)(6)(A) is controlling.<sup>19</sup>

On appeal, appellant contends that Regulation section 1521 conflicts with the above statutory authority (i.e., R&TC, §§ 6091 – 6093) wherein the regulation states that a construction contractor cannot accept a resale certificate to avoid liability for sales or use tax under the listed circumstances. Appellant contends that the statutory authority places no such limitations on the ability of a construction contractor to accept a resale certificate. As such, appellant contends that this is an invalid interpretation of the above statutory authority because the effect is a flat-out prohibition from a contractor accepting a resale certificate for property furnished and installed (other than leased fixtures), which imposes a burden which is not imposed in R&TC section 6092. Appellant also contends that Regulation section 1521(b)(6)(A) conflicts with Regulation section 1668(c), which provides that, absent evidence to the contrary, the seller is presumed to have taken a resale certificate in good faith. Appellant contends that OTA must find in favor of appellant on the basis that Regulation section 1521(b)(6)(A) is invalid to the extent it can be interpreted to preclude a construction contractor from accepting a resale certificate for materials and fixtures that the construction contractor furnishes and installs, as this would conflict with R&TC section 6092 and Regulation section 1668(c).

CDTFA contends that OTA, as an administrative agency, does not have the authority to declare Regulation section 1521 invalid.

OTA's predecessor, the State Board of Equalization (board) issued two precedential decisions discussing a taxpayer challenge to the validity of a regulation promulgated by the Franchise Tax Board (FTB). First, in the *Appeal of Standard Oil Company of California* (83-SBE-068) 1983 WL 15454 (*Standard Oil*), the board concluded that an FTB regulation was

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<sup>19</sup> As noted above, and not relevant to this analysis, CDTFA has revised its position on good faith, but CDTFA has not changed its position that Regulation section 1521(b)(6)(A) is controlling.

invalid. In reaching such determination, the board applied a judicial standard of review used by the California courts when evaluating the validity of a regulation: whether the regulation is arbitrary and capricious or has a reasonable or rational basis. Subsequently, the California Supreme Court examined the question of the applicable standard of judicial review and applied a more expansive two-prong approach: first, whether the regulation is interpretative or quasi-legislative, and second, the court clarified that a standard of lesser judicial deference applies to an interpretative regulation (the court also defined that lesser judicial standard of review, and left the higher judicial standard of review in place, but only for quasi-legislative regulations). (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1 (*Yamaha*)).

The California Supreme Court's holding in *Yamaha* implicitly overturned the board's decision in *Standard Oil* because in *Standard Oil* the board had adopted the judicial standard of review of a regulation as the board's own standard of review of an FTB regulation, and the *Standard Oil* appeal failed to apply the first prong set forth in *Yamaha* (i.e., determining whether the regulation is interpretative or quasi-legislative) when the board overturned FTB's regulation. As a result, when the board next examined this issue, in *Appeal of Save Mart Supermarkets & Subsidiary* (2002-SBE-002) 2002 WL 245682 (*Save Mart*), the board noted that its approach in *Standard Oil* was incomplete (i.e., it was missing the first prong). In addition, the board adopted the two-prong approach set forth in *Yamaha* (i.e., first determining the type of regulation, and then applying an "arbitrary and capricious" standard for quasi legislative regulations and lesser judicial deference for interpretative regulations). Similar to the instant appeal before OTA, in *Save Mart* the taxpayer contended that FTB's regulation added requirements which were not provided in the authorizing statute and, as such, alters and enlarges the words of the statute. The board examined the existing precedent summarized above and concluded that FTB's regulation was entitled to lesser judicial deference, and under that judicial standard of review, the board found FTB's regulation was invalid.<sup>20</sup>

The board never opined, in a precedential decision, on the standard of review of a CDTFA regulation. Notably, it only reviewed CDTFA decisions for a six-month period from July 1, 2017, until December 31, 2017. (Gov. Code, § 15600(d)(2).) Prior to this timeframe, the

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<sup>20</sup> In *Save Mart*, the board reached the "conclusion that Regulation section 23649-3 is invalid." FTB promulgated Regulation section 23649-3 with an operative date of May 31, 1993. (Register 93, No. 18.) The only authority cited for FTB's regulation is R&TC section 19503, which in pertinent part delegates to FTB the authority to prescribe all rules and regulations necessary for the enforcement of Part 11 of the R&TC.

board and CDTFA were one and the same, so the question of the standard of review was a non-issue because they were the board’s own regulations. The law here is clear that a state agency, such as the board, OTA, and CDTFA, cannot refuse to follow its own regulations. (*Newco Leasing, Inc. v. State Bd. of Equalization* (1983) 143 Cal.App.3d 120, 124.)

While OTA has never addressed a challenge to an interpretative regulation, OTA addressed a challenge to a quasi-legislative CDTFA regulation. *Appeal of Talavera*, 2020-OTA-022P, concluded that OTA lacks jurisdiction to find a quasi-legislative CDTFA regulation to be invalid for the following reasons:

In reviewing the legality of such a regulation, an appellate court is limited to determining whether the regulation (1) is within the scope of the authority conferred and (2) is reasonably necessary to effectuate the purpose of the statute. (*Ibid.*) There is a strong presumption that the regulation is valid and the standard on review is confined to the question of whether the regulation is arbitrary, capricious, or without reasonable or rational basis. (*Ibid.*) [OTA] is not a court. (Gov. Code, § 15672.) OTA is an administrative agency and we are precluded by the Constitution of the State of California from declaring a statute unenforceable or refusing to enforce the clear and unambiguous provisions of a statute, unless an appellate court has determined that the statute is unconstitutional. (Cal. Const., Art. III, § 3.5.)

In California, only a court may declare a quasi-legislative regulation that has been formally promulgated by a state agency, such as Regulation 1642, to be invalid. (Gov. Code, § 11350(b).) Therefore, OTA does not have authority to declare [CDTFA’s regulation] invalid and refuse to follow it on that basis.

In summary, *Talavera* concluded that OTA lacks authority to overturn a quasi-legislative regulation (i.e., a regulation subject to the “arbitrary and capricious” standard of judicial deference under *Yamaha*). Subsequently, in *Appeal of Body Wise*, 2022-OTA-340P, OTA reaffirmed the holding of *Appeal of Talavera, supra*, by again concluding that OTA lacks authority to declare another agency’s quasi-legislative regulation invalid or to refuse to follow it on that basis.<sup>21</sup>

Considering the above, it is necessary to take into consideration the fundamental principles of the OTA applicable precedent, *Appeal of Body Wise, supra* and *Appeal of Talavera, supra*, in light of the board’s decision in *Standard Oil*, where the board invalidated an FTB

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<sup>21</sup> The regulations at issue in the precedential OTA cases are Regulation sections 1642 and 1700. The only authority cited for these two regulations is R&TC section 7051, which delegates to CDTFA the authority to prescribe, adopt, and enforce rules and regulations relating to the enforcement of Part 1 of the R&TC.

regulation under the same “arbitrary and capricious” standard applicable to a quasi-legislative regulation.

OTA's Rules for Tax Appeals provide that a “precedential opinion of the [board] that was adopted prior to January 1, 2018, may be cited as precedential authority” unless that status is removed. (Cal. Code Regs., tit. 18, § 30504.) OTA will continue to follow *applicable* board precedent. However, for the reasons discussed below, *Standard Oil* and *Save Mart* are not applicable to the instant appeal because the applicable law and facts have changed, and OTA is required to follow its authorizing legislation. In reaching this conclusion, OTA notes that *Save Mart* and *Standard Oil* present a unique factual and legal situation, because they are distinguishable from the instant appeal not on the basis of the substantive law (e.g. the Revenue and Taxation Code), but based on the authority that the California Legislature extended to OTA under Part 9.5 of Division 3, of Title 2 of the Government Code, when it established OTA, versus the authority conferred on statewide elected officials established under the California Constitution. This case presents a unique scenario which does not impact the status afforded to other precedential board cases.

First, it is important to consider that the law has fundamentally changed since the board, in *Standard Oil* and *Save Mart*, adopted a judicial standard of review for challenges to the validity of another agency’s regulations, and invalidated those regulations under both judicial standards of review. OTA is a state agency organized as part of the executive branch. The law establishing and governing OTA is set forth in Part 9.5 of Division 3 of Title 2 of the Government Code, and the authority of OTA is also set forth in Part 9.5. (See Gov. Code, § 15670(a).) On the other hand, the board is a constitutional body created by the California Constitution, and the members of the board, as elected officials, possess significantly different responsibilities, powers, and duties than members of OTA tax appeals panels who are civil service employees of an executive state agency. Furthermore, the legislature made clear its intent. First, the legislature specified in statute that OTA’s tax panels shall not be construed to be a tax court. (Gov. Code, § 15672(b).) Second, the legislature included a statement of legislative intent in the bill transferring the board’s authority with respect to tax appeals over to OTA:

The Legislature finds and declares . . . (e) The [board’s] current practices support inappropriate interventions by board members in administrative and appeal-related activities, all of which have led to . . . activities contrary to state law.



(Stats. 2017, Ch. 16 (A.B. 102).)

Taking the above statutory framework into context, the underlying laws which existed when the board in *Standard Oil* and *Save Mart* questioned the validity of regulations published in the California Code of Regulations, under a judicial standard of review, and overruled those regulations, have fundamentally changed.

In addition, the facts are different. The board was determining the standard of judicial review that the elected members of the board, acting as a constitutional body, will apply when adopting precedential opinions of the board. Here, the instant case involves the standard that three civil service employees on a tax appeals panel must apply. The governing law establishing the powers and duties of OTA to decide these appeals was established after *Save Mart* and *Standard Oil* were decided. OTA, while a successor to the board, is not the board. The laws authorizing OTA to conduct and decide tax appeals from CDTFA and FTB are fundamentally different from the laws which existed when the board presided over FTB's tax appeals. As such, this Opinion finds that the standard of judicial deference adopted by the board in cases such as *Standard Oil* and *Save Mart* are not applicable precedent for OTA, because the underlying law applicable to those cases is distinguishable and different from the underlying law applicable to appeals before OTA.<sup>22</sup>

The instant appeal places OTA squarely in the position of being asked to overturn and refuse to follow a section contained in the California Code of Regulations. For the reasons discussed above, the board's approach in *Standard Oil* and *Save Mart*, to the extent these cases address judicial deference and judicial standard of review, does not provide relevant or applicable guidance for OTA to follow in the instant appeal, because the facts and law are distinguishable. (See Gov. Code, § 15672(b).) This Opinion reaffirms the conclusions in *Appeal of Talavera, supra*, and *Appeal of Body Wise, supra*. This Opinion finds that OTA does not have authority to declare Regulation section 1521 invalid or to refuse to follow it on that basis. CDTFA cannot refuse to follow Regulation section 1521 on this basis, and by extension, neither can OTA. (*Newco Leasing, Inc. v. State Bd. of Equalization, supra*, 143 Cal.App.3d 120, 124; see Gov. Code, § 15672.)

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<sup>22</sup> This Opinion need not, and does not, retroactively examine whether the board correctly decided *Save Mart* and *Standard Oil*.

No precedential OTA case has overturned, refused to follow, or invalidated a section in the California Code of Regulations. This Opinion builds upon this earlier body of OTA precedent, and continues to find no authority for OTA to do so.<sup>23</sup> As such, this Opinion concludes that OTA lacks jurisdiction to resolve appellant’s argument that Regulation section 1521 is invalid on the basis that it conflicts with R&TC sections 6091 and 6092, and Regulation section 1668(c).<sup>24</sup>

Issue 5: Whether there are errors in the audit calculations.

Appellant contends that CDTFA made errors in the audit calculations and the liability includes nontaxable installation labor. In support, appellant refers to a spreadsheet it provided during the audit, which identifies a total contract amount with Big West of \$7,588,424.11, nontaxable amounts totaling \$1,154,353.07, a 5 percent markup, and a taxable measure of \$6,813,492.25. Additionally, appellant argues that the cost of some components (as identified on the spreadsheet) should be removed from the taxable measure because the components are removable and replaceable and are not a permanent part of the SCR system.

Here, CDTFA reviewed appellant’s sales journals and sales invoices to establish the taxable measure on an actual basis. This Opinion finds CDTFA’s audit methodology to be reasonable and rational under the facts. As such, CDTFA has met its initial burden of proof. Thus, the burden of proof shifts to appellant to establish that a result differing from CDTFA’s determination is warranted. However, appellant has not presented complete supporting source documentation for the taxable measure of \$6,813,492.25 identified on appellant’s spreadsheet. Notably, appellant has not provided a single purchase order, and appellant only provided 15 out of 63 invoices. Some the agreements are unsigned, some are incomplete, and some of the pages are illegible. Appellant had the burden of establishing that an adjustment was warranted, and appellant failed to provide sufficient documentation to warrant any adjustments.

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<sup>23</sup> This Opinion does not address the deference, if any, afforded an underground regulation or other rule or regulation which has not been adopted by the agency, filed with the Secretary of State, and published in the California Code of Regulations. (See Gov. Code, § 11344(a).)

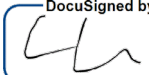
<sup>24</sup> *Save Mart* involved a challenge to a regulation which, as with Regulation section 1521, only cites as authority the general delegation of authority to the promulgating agency to adopt regulations. (R&TC, §§ 7051 [CDTFA], 19503 [FTB].) On the other hand, the wording of the general delegation of authority for CDTFA is different than it is for FTB. (See R&TC, §§ 7051, 19503.) In reaching the conclusion that OTA lacks jurisdiction to address appellant’s challenge to Regulation section 1521, this Opinion need not address whether Regulation section 1521 is interpretative, quasi-legislative, or both.

HOLDINGS

1. Appellant did not sell machinery and equipment to Big West.
2. Appellant did not accept the resale certificate in good faith.
3. Equitable estoppel is inapplicable.
4. OTA lacks jurisdiction to invalidate or refuse to follow Regulation section 1521.
5. Appellant failed to establish errors in the audit calculations.

DISPOSITION

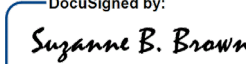
CDTFA’s action is sustained.

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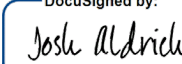
Andrew J. Kwee  
 Administrative Law Judge

We concur:

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Suzanne B. Brown  
 Administrative Law Judge

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Josh Aldrich  
 Administrative Law Judge

Date Issued: 12/15/2022