

BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF, )  
 )  
NANOLAB TECHNOLOGIES, INCORPORATED, ) OTA NO. 22029660  
 )  
 APPELLANT. )  
 )  
 )

## TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, February 22, 2024

Reported by:  
ERNALYN M. ALONZO  
HEARING REPORTER

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Transcript of Electronic Proceedings,  
taken in the State of California, commencing  
at 1:28 p.m. and concluding at 2:38 p.m. on  
Thursday, February 22, 2024, reported by  
Ernalyn M. Alonzo, Hearing Reporter, in and  
for the State of California.

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Panel Lead:	ALJ JOSHUA ALDRICH
Panel Members:	ALJ MICHAEL GEARY ALJ SHERIENE RIDENOUR
For the Appellant:	ARTHUR RINSKY LAUREN RINSKY THOMAS BYRD
For the Respondent:	STATE OF CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION  COURTNEY DANIELS JARRETT NOBLE JASON PARKER

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I N D E X

E X H I B I T S

(Appellant's Exhibits 1-8 will be admitted pursuant to a post-hearing order.)

(Department's Exhibits A-I will be admitted pursuant to a post-hearing order.)

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California; Thursday, February 22, 2024  
1:28 p.m.

JUDGE ALDRICH: This is Judge Aldrich. We're opening the record in the Appeal of Nanolab Technologies, Incorporated before the Office of Tax Appeals, OTA Case No. 22029660. Today's date is Thursday, February 22nd, 2024, and it's approximately 1:30.

This hearing is being conducted electronically, and it is also being recorded. The hearing is being heard by a panel of three Administrative Law Judges. My name is Josh Aldrich. I'm the lead Judge for purposes of conducting the hearing. I'm joined by Judge Geary and Judge Ridenour. During the hearing, Panel members may ask questions or otherwise participate to ensure that we have all the information needed to decide this appeal. After the conclusion of the hearing, we three will deliberate and decide the issue or issues presented.

As a reminder, the Office of Tax Appeals is not a court. It is an independent appeals body. The panel does not engage in ex parte communications. Our opinion will be based off the parties' arguments, admitted evidence, and the relevant law. We have read the parties' submissions, and we're looking forward to hearing your arguments today.

1                   Who is present for Appellant?

2                   MR. RINSKY:   Arthur Rinsky and Lauren Rinsky and  
3                   Thomas Byrd the -- he's a CPA, and he is Appellant's vice  
4                   president of finance and administration.

5                   JUDGE ALDRICH:   Thank you.

6                   For CDTFA, who is present?

7                   MS. DANIELS:   Courtney Daniels.   We also have  
8                   Jarrett Noble.

9                   MR. NOBLE:   Oh, sorry.   Jarrett Noble.   I hit the  
10                  mute button when I thought it was unmute.   Sorry about  
11                  that.

12                  JUDGE ALDRICH:   No problem.

13                  Sorry.   Was that Mr. Parker?

14                  MR. PARKER:   Yes.   Jason parker.

15                  JUDGE ALDRICH:   Thank you.

16                  All right.   So in the January 26, 2024 minutes  
17                  and orders as distributed to the parties, it effectively  
18                  summarized two related issues.   The stated issue was  
19                  whether the contracts is currently in dispute, i.e.,  
20                  Focused Ion Beam Circuit Edit Services, constitute  
21                  qualified research and development contracts pursuant to  
22                  California Code of Regulations, title 18, section 1501.1,  
23                  and, if not, whether the services at issue constitute  
24                  repair labor.

25                  So I have an edit to that that I'd like to

1     propose.  Instead, I think it should read, whether the  
2     services currently in dispute are exempt under California  
3     Code of Regulations, title 18, section 1501.1, and, if  
4     not, whether the services at issue constitute nontaxable  
5     repair labor.  I think that's a bit more narrow and better  
6     captures the issue statement on appeal.

7             I'll start with Appellant's representative --  
8     yes.

9             MR. RINSKY:  Can I make one comment?  Related to  
10    the Section 1501.1 issue, something that, Judge Aldrich,  
11    you raised at the prehearing conference, and it's clearly  
12    addressed in our original appeal.  And then one of the  
13    additional briefs that we filed, I think, related to that  
14    1501.1 issue is the whole true object was a transaction  
15    issue.  And I think that we want to address that because  
16    it's this confidentiality and no property fact that --  
17    that we believe should have that raised instead of --

18            JUDGE ALDRICH:  So --

19            MR. RINSKY:  So, that would relate in the sense  
20    to the 1501.1.  But it's the two issues you mentioned,  
21    but, really, it's part of that first one.  It's an  
22    inherent question.  What's the true object?

23            JUDGE ALDRICH:  Okay.  And I appreciate that.  
24    With that said, I'll note that issue statements may be  
25    subject to change based off the parties' argument.  So if

1       that's something you're going to be arguing, we may modify  
2       it for purposes of our opinion.

3               With respect to the Department, do you have any  
4       issues, Ms. Daniels, with the issue statement that I  
5       modified?

6               MS. DANIELS: No. The Department doesn't have  
7       any problems with the modifications. Thank you.

8               JUDGE ALDRICH: Okay. So next I'd like to  
9       address exhibits. So the exhibits will not be admitted  
10      today. Rather, the exhibits will be admitted pursuant to  
11      a post-hearing order, but I wanted to go over them so  
12      we're all on the same page.

13              CDTFA's exhibits were identified alphabetically  
14      as Exhibits A through I. They were timely submitted during  
15      the briefing process. Excel copies of the audit work  
16      papers were submitted after the prehearing conference  
17      pursuant to OTA's or the Office of Tax Appeals request.  
18      And that request was made to facilitate the creation of a  
19      hearing binder for the parties.

20              However, I do want to note that the audit work  
21      papers were previously provided in briefing between  
22      July 5th, 2022, and February 6th, 2023. Those  
23      submissions, so the ones that occurred between July 5th,  
24      2022, and February 6, 2023, are the actual items that will  
25      be offered into the evidence, not the Excel spreadsheet.



1       At least that's my understanding.

2               With respect to Appellant's exhibits, they are  
3       identified as Exhibits 1 through 8. Prior to the  
4       prehearing conference, Appellant identified Exhibits 1  
5       through 5. Thereafter, Appellant submitted Exhibits 6  
6       through 8. They were timely submitted after the  
7       prehearing conference.

8               So during the prehearing conference, neither  
9       party had objections to admitting the other parties'  
10      respective exhibits into evidence. And the minutes and  
11      orders also provided the deadline for written objections.

12              Are there any objections now as to the  
13      admissibility of the exhibits? I'll start with  
14      Appellant's counsel.

15              Mr. Rinsky?

16              MS. RINSKY: Other than what was discussed  
17      already about redaction and all that? Then we wouldn't.

18              JUDGE ALDRICH: Yes.

19              MS. RINSKY: Then there wouldn't be any  
20      objections. It's just to the names and addresses.

21              JUDGE ALDRICH: And that will be covered in the  
22      post-hearing order.

23              So -- and then with respect to the, Department,  
24      do you have any objections to Appellant's proposed  
25      exhibits?

1 MS. DANIELS: No. The Department does not have  
2 any objections. Thank you.

3 JUDGE ALDRICH: Great.

4 So as I indicated previously, the parties are  
5 free to refer to the exhibits and the exhibit numbers as  
6 exhibits, but they are not currently admitted into  
7 evidence. And that will be done via post-hearing order.

8 So moving on. So just so everyone has an idea of  
9 how this hearing is going to proceed, Appellant will  
10 present an opening presentation, including testimony for  
11 approximately 30 minutes. Next, CDTFA will have an  
12 opportunity to present a combined opening and closing for  
13 30 minutes. Then the Panel will ask questions of the  
14 parties for approximately 5 to 10 minutes. And finally,  
15 Appellant will have the opportunity for closing remarks or  
16 a rebuttal. These estimates are made for calendaring  
17 purposes. If you need more time, please ask. And if you  
18 need to take a break also please let me know.

19 My understanding with respect to witness  
20 testimony is that Mr. Byrd is going to be testifying.

21 Is that accurate, Mr. Rinsky?

22 MS. RINSKY: He might just be --

23 MR. RINSKY: He might.

24 MS. RINSKY: -- available for questions.

25 MR. RINSKY: The reason we had his declaration

1 submitted is to save time. So if he were going to  
2 testify, those are under oath. That's what he'd be  
3 testifying to. So at this point, we don't plan on having  
4 him testify other than maybe to clarify if this Body has  
5 questions, verification about the things in the  
6 declaration. But, otherwise, the purpose of submitting  
7 those was to save time.

8 JUDGE ALDRICH: I appreciate that.

9 MS. RINSKY: So if you have -- if -- sorry,  
10 Judge Aldrich.

11 If you have -- if the Judges have questions later  
12 on and -- we might have him answer the question if we  
13 think that would be more --

14 JUDGE ALDRICH: Thanks, Ms. Rinsky.

15 MS. RINSKY: Yeah. Does that make sense?

16 JUDGE ALDRICH: So at this time it would be a  
17 good idea to swear Mr. Byrd in. That way if we do have  
18 questions for him, we don't have to revisit swearing him  
19 in or making sure that the record accurately reflects  
20 that.

21 Mr. Byrd, would you mind raising your right hand.

22

23 T. BYRD,

24 produced as a witness, and having been first duly sworn by  
25 the Administrative Law Judge, was examined, and testified

1 as follows:

2

3 JUDGE ALDRICH: Thank you, sir.

4 Okay. We've established how the hearing is to  
5 proceed. We've addressed exhibits. We've addressed the  
6 issue statement. We've addressed witness testimony.

7 And so now we're ready for you, Mr. Rinsky. Are  
8 you ready to proceed with your opening?

9 MR. RINSKY: Yes, I am. Yes, I am.

10 JUDGE ALDRICH: Go ahead.

11

12 PRESENTATION

13 MR. RINSKY: Good afternoon my name is Arthur  
14 Rinsky. I'm here with my partner Lauren Rinsky, and we're  
15 counsel for Appellant Nanolab. And with us also is Thomas  
16 Byrd, as I said, a CPA and Appellants VP of finance and  
17 administration.

18 I'd like to begin with an overview. It's the  
19 position of Appellant that, based on uncontroverted sworn  
20 evidence submitted by Appellant to this appeals body and  
21 admissions by Respondent, Appellant's FIB/CE Transactions  
22 are not subject to tax for one or more of the more  
23 following reasons: Number one, the transactions are  
24 exempt as R&D transactions under Regulation  
25 section 1501.1. Number two, in order for Respondent to

1     subject the transaction to tax, true object of the  
2     transaction must be the transfer or use of a taxpayer's  
3     tangible personal property. In a FIB/CE Transaction,  
4     Appellant never has any personal property to convey. And  
5     because the client item is occasionally destroyed in the  
6     transaction, true object can be the transfer by Appellant  
7     of tangible personal property in order to complete the  
8     transaction.

9             And in any event, these FIB/CE Transactions can't  
10    be fabrication because they don't change the intended use  
11    or purpose of the relevant client item. In fact, they  
12    can't because it's a small piece of a larger item. And it  
13    would be reinventing the entire big wheel that that this  
14    little item is just a small part of.

15            As Judge Geary mentioned in the precedential case  
16    of AMB [sic] Care Collective, where taxpayer challenges a  
17    Notice of Determination or NOD. Respondent has a minimal  
18    initial burden of showing its determination is reasonable  
19    and rational, and then the burden shifts to the taxpayer  
20    to show that differing result should apply. It's  
21    Appellant's position, as discussed in more detail in  
22    this --

23            JUDGE RIDENOUR: Excuse me. I'm going to have  
24    to -- I can't hear you. I believe you hit the mute  
25    button. So if you can maybe go back to --

1 MR. RINSKY: Oh, I hate the computer.

2 MS. RINSKY: When did you hit the mute button?

3 MR. RINSKY: I don't know.

4 JUDGE RIDENOUR: We're on the record.

5 MR. RINSKY: We're on the record. Okay. Well --

6 MS. RINSKY: Really? The whole time?

7 MR. RINSKY: Yeah. My dad always used to say I

8 hate the computer, and some days I do.

9 MS. RINSKY: Let me just watch this.

10 MR. RINSKY: Let me begin again.

11 So I'd like to begin with an overview. It's the

12 position of Appellant that based on the uncontroverted

13 sworn evidence submitted by Appellant's to this appeals

14 body and admissions by Respondent, Appellant's FIB/CE

15 Transactions at issue are not subject to tax for one or

16 more of the following reasons:

17 Number one, these transactions are exempt as R&D

18 transactions under Regulation 1501.1. And Lauren will go

19 through that in more detail.

20 In order for Respondent to subject the

21 transaction to tax, true object of the transaction must be

22 the transfer or use of a taxpayer's tangible personal

23 property. In a FIB/CE Transaction, Appellant never has

24 any personal property to convey because of these

25 confidentiality agreements that make it clear that

1       whatever we do with the item, it still stays the client's.  
2       And because the item is occasionally destroyed and the  
3       transactions can still be completed, it can't be.  
4       Tangible personal property cannot be the true object of a  
5       FIB/CE Transaction. And finally, in any event, the FIB/CE  
6       Transactions are not fabrication as they do not change the  
7       intended use or purpose of the relevant item.

8               As Judge Geary stated in the precedential case of  
9       Appeal of AMB [sic] Care Collective, when a taxpayer  
10      challenges a Notice of Determination, Respondent has a  
11      minimum additional burden of showing the determination is  
12      reasonable and rational. And then the burden of proof  
13      shifts to the taxpayer to show that a different result  
14      should apply.

15             It's Appellant's position, as discussion in more  
16      detail in this presentation, Respondent's own admissions,  
17      the substantial sworn uncontroverted evidence previously  
18      submitted by Appellant to OTA in this case, establish that  
19      the appeal of Notice of Determination is not reasonable or  
20      rational in subjecting Appellant's FIB/CE Transactions to  
21      tax. Note also our Exhibit Number 4 where we've tried  
22      repeatedly to find out if they have anything to controvert  
23      our affidavits and all the evidence we've submitted.

24             I will now defer to my partner Lauren to discuss  
25      the application of Regulation section 15.01 [sic] to

1 FIB/CE Transactions.

2 MS. RINSKY: Hi. This is Lauren Rinsky speaking.

3 So I intend to refer to Appellant by Nanolab, but  
4 if that's --

5 Oh, one moment, please. We're having a landline  
6 interference. We're moving battery?

7 MR. RINSKY: Yeah.

8 MS. RINSKY: All right. I will continue. Okay.

9 So Nanolab's the FIB Circuit Services  
10 constitute -- it's our position that Nanolab's FIB Circuit  
11 Edit Services constitute qualified research and  
12 development contracts under Regulation 1501.1(a), and  
13 Regulation 1501.1(a) has -- there's two requirements.  
14 There is first one, a discovery of information, which --  
15 and, which is in Regulation 1501.1(a)(1)(A), and there's  
16 the delivery of that information, which is in  
17 Regulation 1501.1(a)(1)(b).

18 So I'm going to address the discovery of  
19 information. In Regulation 1501.1(a)(1)(A), that provides  
20 that under a qualified research and development contract  
21 that the services undertaken to discover information which  
22 is technical in nature and the results of which are  
23 intended to be useful in the development of new or  
24 improved product process technique or invention. And in  
25 here, in all of the FIB's Circuit Edit Services at issue,



1 Nanolab renders services on proprietary items of its  
2 clients to discover -- oh, yeah, something -- to discover  
3 information that's technological in nature, such as why  
4 the item is not performing as desired by the client and  
5 the result of which are intended to be useful in  
6 development of new or approved product, process,  
7 technique, or invention.

8 More specifically, in the FIB Circuit Edit  
9 Services, the engineers at Nanolab, they edit the  
10 propriety item of the client so that the edits can be  
11 inspected, examined, and tested to discover information  
12 that's technological in nature as set forth in the  
13 Exhibits 1, 2, 3, 7, and 8, which are the affidavits by  
14 the engineers at Nanolab and of Thomas Byrd who is with us  
15 today.

16 Moreover, the CDTFA admits in its AIS Memo, which  
17 is the audit and information section memo dated  
18 January 24th, 2018. It admit that the value of a FIB  
19 Circuit Edit Services is alteration of the microchip so  
20 that, quote, "Design and/or process improvements can be  
21 examined and tested," quote. Further, the CDTFA admits in  
22 its August 17th, 2018, audit report -- oh, sorry -- the  
23 AIS Memo is Exhibit, A, page 52.

24 And the -- continue on -- the CDTFA admits in its  
25 August 17th, 2018, audit report, which is Exhibit A,

1 page 43 and 44, that Nanolab performed services on the  
2 clients' proprietary devices, and that Nanolab returned  
3 the dissected services to the clients, quote, "For their  
4 own testing and analysis," quote.

5 And I would like to point out that per  
6 Regulation 1501.1(a)(7), information and testing use  
7 includes use by either the contractor, Nanolab, or its  
8 customers, the clients. Yeah. Thus, as evident from the  
9 affidavits in Exhibits 1, 2, 3, 7 and 8, and the  
10 admissions by the CDTFA in the audit report and the AIS  
11 Memo, the Fib Circuit Edit Services were undertaken for  
12 the purpose of discovering technological information as to  
13 client propriety items. And that information was intended  
14 to be useful in the development of new or improved  
15 products, process, technique, or invention by Nanolab's  
16 clients.

17 With respect to delivery of information.  
18 Regulation 1501.1(a)(1)(B) provides that the -- or it  
19 states, the contract calls for delivery of a report  
20 detailing information developed by the contractor or other  
21 tangible personal property incidental to the true object  
22 of the contract as defined by 1501. Here, in all the FIB  
23 Circuit Edit Services at issue, engineers at Nanolab  
24 convey the discovered information to Nanolab's clients by  
25 one or more of the following: An email, a phone call, or

1 delivery of the propriety item or pieces of the propriety  
2 item to the extent not destroyed.

3 And this is set forth in the affidavits in  
4 Exhibits 1, 2, 7, and 8. And this is Regulation 1501.1  
5 And it's not disputed by the CDTFA. And that is in -- or  
6 it is set forth in Respondent's Exhibit A, which is the  
7 Appeals Bureau decision on page 12. And then further, for  
8 the purpose of Nanolab's -- further, for the purpose of  
9 Nanolab's return to its clients of any undestroyed client  
10 proprietary item. That purpose fits squarely within  
11 Regulation 1501.1(a)(1)(B), a delivery of information  
12 requirement, and also Regulation 1501.1(a)(7), which  
13 provides the information in testing use includes use by  
14 either the contractor Nanolab or its customers, the  
15 clients.

16 Accordingly, the delivery of information  
17 requirement of the Regulation 1501.1(a)(1)(B) is satisfied  
18 as to the Fib Circuit Edit Services. And thus, the Fib  
19 Circuit Edit Services were rendered to pursuant to a  
20 qualified research and development contract under  
21 Regulation 1501.1(a), and the Notice of Determination is  
22 erroneous because the receipts for those FIB Circuit Edit  
23 Services are not subject to tax as provided by  
24 Regulation 1501.1(b).

25 And then just at the -- before I defer to my

1 partner Arthur Rinsky, I wanted also to just point out  
2 that in addition to 1501.1(a)(7), which discusses how the  
3 information and testing use includes use by either the  
4 contractor Nanolab or its customer, the clients, I just  
5 want to point out that Section 15 -- Regulation  
6 1501.1(a)(5), dealing with custom-made items. It states  
7 that the custom-made items does not include property the  
8 purchaser, Nanolab's clients, will use for information and  
9 testing purposes as defined in(a)(7), which is the  
10 information testing use.

11 And then I also just want to point out that in  
12 Section 1501.1(a)(6), which talks about functional use,  
13 and it explains functional use is the type of use that  
14 occurs after the completion of the research and  
15 development and that custom-made items are intended for  
16 functional use, not for information and testing use. And  
17 in this case it appears that everyone seems to agree  
18 that -- that -- yeah. That it's being returned for  
19 information testing use by Nanolab, by its clients. And  
20 then also that 1501.1(a)(6) with functional use, it also  
21 there, again, specifies that the information and testing  
22 use of a prototype by the contractor Nanolab or its  
23 customer does not qualify as functional use.

24 And then now I will defer to my partner Art  
25 Rinsky for the balance of our presentation.

1           MR. RINSKY: So even if this body concludes that  
2 despite Respondent's submissions of the uncontroverted  
3 sworn evidence of the contrary that Regulation  
4 section 1501.1 should apply to the FIB/CE Transactions,  
5 nevertheless, those transactions do not and cannot have as  
6 their true object the transfer or use of tangible personal  
7 property of Nanolab. In a FIB/CE Transaction, this is  
8 because in these types of transactions, Appellant never  
9 has any property of its own to convey.

10           This is the reason why we're so concerned about  
11 the NDA, the disclosure. We have no proprietary interest  
12 in anything that's done with these items or that relates  
13 to the item. And if we try to take a position, we would  
14 be out of business. Thus, we don't have any property  
15 that's ours to convey in these transactions. All we can  
16 do is return the client's property to the client, and  
17 that's it.

18           You can see, for example, the Exhibit 7, sections  
19 8 and 9, the confidentiality agreement which even covers  
20 R&D results. These are very broadly gone because the  
21 people have spent a fortune on these -- on the items that  
22 they're asking us to figure out why they aren't working.  
23 The fact that Appellant has no property to convey in these  
24 transactions, distinguishes this case from both Culligan  
25 Water Conditioning and Appeal of Thomas Conglomerate, that

1 Judge Aldrich asked us to address.

2 In both of those cases, the delivery or use of  
3 tangible property was an integral part of the transaction  
4 at issue. This no property to convey situation was also  
5 the situation and annotation 515.0680 that Judge Aldrich  
6 asked us to be prepared to address. That annotation, by  
7 the way, as well as the two cases predate Regulation  
8 1501.1. In the annotation, the contractor, the taxpayer,  
9 had no rights in anything that was developed with respect  
10 to the client's property, and there was no specification  
11 as to how information developed was to be conveyed. Those  
12 are exactly the facts of FIB/CE Transaction because they  
13 can be completed without transferring any property. See,  
14 for example, Exhibit 7, section 9, and, again, that  
15 confidentiality agreement.

16 Today agreements, such as the NDAs that were  
17 attached to Appellant's Exhibit 7, protect the client's IP  
18 from the get go. For that reason, there's no property for  
19 a contractor, such as Appellant, to assign back at the end  
20 of the FIB/CE Transaction. In the annotation 5150680, I  
21 guess IP was more primitive in 1950. And so the owner of  
22 the proprietary item had the contractor assign back  
23 anything that it developed or whatever. But here they  
24 don't have to do it because based on the confidentiality  
25 agreement, they always own it. We don't ever own

1 anything.

2 Second, the true object of these transactions is  
3 for Appellant to determine and fix the root cause of the  
4 client failure -- item's failure, not to make a new item  
5 but fabricate a new. Again, if you look at the  
6 confidentiality agreement that's attached to Exhibit 7,  
7 can even see the client's notation. "Root cause of the  
8 failure. Why isn't this thing working?" And they need it  
9 to work because if it doesn't work, the item of which is a  
10 part of what we're -- so Appellant accomplishes this, the  
11 FIB/CE, by using a multi-million dollar instrument that's  
12 a vacuum chamber, and they do the editing and whatever  
13 they're doing with the item in the chamber. It doesn't  
14 change the purpose or intended use of the -- of the item.  
15 That's the definition of fabrication.

16 Throughout this case, there's been talk by  
17 Respondent of fabrication, but nobody ever bothers to  
18 defines what that means. We're not fabricating anything.  
19 We're trying to fix something that's broken and not  
20 working. I refer you to Exhibits 1, sections 4 through 9,  
21 2, sections 4 through 9, 3, sections 6 through 10, 7,  
22 sections 8 and 9, and the attached NDA. Look at also  
23 Exhibit C showing that the client understands that a  
24 FIB/CE Transaction is, in fact, FA, failure analysis  
25 testing. This is from the client who is not involved in

1 the tax case.

2 Third, in a FIB/CE Transaction -- and this is  
3 something that I didn't completely understand -- because  
4 all of this work is done in a vacuum chamber, when you  
5 take the item out, it starts to oxidize and degrade, and  
6 it becomes useless. So if we take it out for testing and  
7 oxidizes and essentially degrades and it's no good, if we  
8 reseal it so the client can look at what we did and they  
9 open it up so they can see what we did, it starts to  
10 degrade and it's no good. So the oxidation issue also  
11 says that the object itself can't be the true object.

12 Finally, a fact that I viewed most critical here,  
13 is the fact that the client's item in a FIB/CE Transaction  
14 can be destroyed and, yet, the transaction can still be  
15 completed. Now, Respondent concedes that this destruction  
16 occurred occasionally. And, in fact, Respondent's own  
17 hearing officer found that sometimes the client requested  
18 it to be destruction -- that it be destroyed. They're so  
19 sensitive as to what this item is.

20 So this destruction fact, the fact you can have  
21 it destroyed and still complete the transaction  
22 distinguishes this case from both Culligan Water  
23 Conditioning where there were exchanged units and Appeal  
24 of Thomas Conglomerate where there were CDs, DVDs, and  
25 photos. In each of those cases, delivery or use of



1     tangible personal property was an integral part of the  
2     transactions at issue. The fact that the client wants the  
3     undestroyed item on which the services were rendered  
4     returned for informational testing and purposes is  
5     admitted by Respondent as Lauren pointed out earlier.

6             That does not make the property the true object  
7     of the transaction. Rather, the true object of the  
8     transaction is one of delivery of the report detailing  
9     information, which they need if the thing has been  
10    oxidized and is no good -- as it happens when they take it  
11    out of the chamber -- or a portion of the report or the  
12    delivery of what's left of the item after we're through  
13    with it. It can't be the item.

14            And finally, even if this body concludes, despite  
15    the uncontroverted sworn evidence and Respondent's  
16    admissions to the contrary that somehow FIB/CE  
17    Transactions aren't exempt from tax under Regulation  
18    section 1501.1, and that somehow even though the property  
19    gets destroyed in the process so we can still carry out  
20    the transaction and we have no rights in the property at  
21    all but, nevertheless, our property transfer to them is  
22    the true object of the transaction. It doesn't matter  
23    because these transactions are not fabrications, and  
24    they're repairs.

25            The definition of fabrication is in Appeal of

1 Praxair, which is cited in our briefs, page 25. And it's  
2 where you change the original purpose or function of the  
3 item. That's not what's going on in any case with the  
4 FIB/CE. We're trying to get something that's not working  
5 to work. That's not changing the purpose or function.  
6 And finally in the FIB/CE process to the extent that there  
7 are items that we use in the vacuum chamber to play around  
8 with the client's item, we pay tax on those items. And,  
9 of course, they oxidize as soon as we take it out.

10 So in sum, there's no rational or reasonable  
11 basis for the Respondent to subject the FIB/CE  
12 Transactions to tax or the Notice of Determination. This  
13 is because those transactions were exempt from taxes, R&D  
14 transactions. Delivery of tangible personal property was  
15 not and could not be the true object of these transactions  
16 because the relevant client item is occasionally  
17 destroyed. And anything done to that item always remained  
18 the client's property, so we have nothing which we have  
19 title to convey.

20 And number three, to the extent that the  
21 transactions aren't otherwise exempt under the regulation,  
22 the R&D regulation, or the true object test, it could not  
23 be fabrication because they didn't change the intended use  
24 of the purpose of the client item. It only involved  
25 fixing an item that was not functioning as intended by the

1 client. And Appellant paid tax on any item used to  
2 correct that function.

3 And thus, that concludes our initial  
4 presentation.

5 JUDGE ALDRICH: Thank you, Mr. Rinsky.

6 At this time, I'm going to refer to my Panel  
7 members to see if they have any questions, or they can  
8 defer until after CDTFA's presentation.

9 Judge Ridenour, do you have any questions?

10 JUDGE RIDENOUR: Not at this time. Thank you.

11 JUDGE ALDRICH: And Judge Geary?

12 JUDGE GEARY: I might. It occurs to me that if  
13 we have factual questions about the processes, we need to  
14 ask Mr. Byrd those questions. And it also seems to me  
15 that the Respondent has not yet offered an argument and  
16 might be entitled to the benefit of additional information  
17 from Mr. Byrd before it gives its argument. Do I  
18 understand, Judge Aldrich, that the Respondent is going to  
19 be giving just one argument?

20 JUDGE ALDRICH: That's correct, a combined  
21 opening and closing.

22 JUDGE GEARY: Then I think I probably should ask  
23 my questions of Mr. Byrd now. I might have more of him  
24 later after Respondent argues. But I think maybe a few  
25 questions of Mr. Byrd now, if I'm allowed.

1 JUDGE ALDRICH: Please proceed.

2 Mr. Rinsky and Ms. Rinsky, just a reminder to  
3 mute when you are not actively speaking. Thank you.

4 JUDGE GEARY: Good afternoon, Mr. Byrd. You  
5 submitted several declarations. I believe two or three of  
6 them if I'm not mistaken; is that right?

7 MR. BYRD: That's correct.

8 JUDGE GEARY: Okay. I'm trying to get a handle  
9 on what happens to the devices that your clients give to  
10 your company to do, whatever it is your client is going to  
11 be doing to these devices. Specifically, Mr. Rinsky  
12 indicated that the work that was done never changes the  
13 purpose of the item. But isn't one of the questions  
14 whether it changes the function of the item? And if I  
15 understand correctly, what some of the things that  
16 Nanolabs does is that it actually alters. Let's say it's  
17 an integrated circuit. It actually, in some instances,  
18 alters the integrated circuit and returns to the client a  
19 circuit that is different than the one that was given to  
20 Nanolabs. Is that wrong or right?

21 MR. BYRD: That's correct.

22 JUDGE GEARY: It does do that on occasion. So do  
23 you know whether or not the documents that were provided  
24 to Respondent in the course of the audit are sufficiently  
25 detailed to enable Respondent to conclude whether or not

1 the device that was returned to the client was, in fact,  
2 different than the device that the client first gave to  
3 Nanolabs?

4 MR. BYRD: My recollection is that pictorial  
5 evidence was presented as an example to the auditors  
6 during the process showing them how the circuit was  
7 opened, how it was changed, and then resealed.

8 JUDGE GEARY: But that's not what Nanolab does in  
9 every case; correct?

10 MR. BYRD: In the context of FIB Circuit Edits,  
11 that is the general course of action.

12 JUDGE GEARY: Okay.

13 MR. RINSKY: -- test, right?

14 JUDGE ALDRICH: Mr. Rinsky, you'll have an  
15 opportunity, but I'd ask you don't interrupt Judge Geary.

16 JUDGE GEARY: I also have just one or two  
17 questions about the oxidation process. And I believe  
18 Mr. Rinsky indicated that when this kind of FIB/CE work is  
19 done, there are times when exposure to air causes  
20 oxidation and degrades and sometimes destroys the device  
21 on which Nanolab did the work. Is that a fair statement  
22 of what happens?

23 MR. BYRD: Yes, that's correct.

24 JUDGE GEARY: Would you also say that happens  
25 occasionally? Would that be a term you would use to

1 describe how often it happens?

2 MR. BYRD: Can I ask for some clarification?

3 JUDGE GEARY: Sure.

4 MR. BYRD: So you're saying that the oxidation  
5 occasionally happens or occasionally gets -- the object  
6 occasionally gets destroyed?

7 JUDGE GEARY: I think you already said that it  
8 occasionally happens. How often does it happen that the  
9 object is destroyed and you, in effect, return nothing to  
10 the client?

11 MR. BYRD: Full destruction is a sometimes  
12 scenario.

13 JUDGE GEARY: Okay.

14 MR. BYRD: Yes.

15 JUDGE GEARY: Do you know whether the records  
16 that were given to Respondent for purposes of audit  
17 identify those instances in which there was full  
18 destruction of the object on which Nanolab did it its  
19 work?

20 MR. BYRD: We were not able to provide evidence  
21 to the auditors in that case primarily due to  
22 confidentiality agreements. We're not able to retain  
23 photos and other pictorial evidence related to that. So,  
24 no, we did not have any evidence to provide directly to  
25 show destruction.

1 JUDGE GEARY: Let me ask for some clarification  
2 of the response you just gave. Are you saying that you  
3 were not able to do it because you simply do not have such  
4 records because you are prohibited by the NDAs from  
5 keeping such records?

6 MR. BYRD: That is correct.

7 JUDGE GEARY: All right. I believe those are the  
8 only questions I have for Mr. Byrd at this time. Thank  
9 you, Judge Aldrich.

10 JUDGE ALDRICH: Thank you, Judge Geary.

11 JUDGE GEARY: Thank you, Mr. Byrd.

12 JUDGE ALDRICH: Mr. Rinsky, did you have  
13 something to interject?

14 MR. RINSKY: My understanding -- because, again,  
15 I'm not an engineer -- is that the oxidation occur. You  
16 can test what we've done two ways. Either we test it, or  
17 the client tests it. Or we both, if they don't trust our  
18 testing. But the minute you unseal it, in other words, we  
19 take it out of the vacuum chamber if we're doing the  
20 testing, it's my understanding that it begins to degrade.

21 If we reseal it when we take it out so it doesn't  
22 degrade instantaneously and we give it to them so they can  
23 look at it, the minute they open it up and look at it, it  
24 starts to oxidize and degrade. That's my understanding.  
25 I mean, Thomas can clarify that or not. But bottom line

1 is you just can't open it up and look at what we did  
2 without it starting to degrade.

3 JUDGE ALDRICH: Mr. Byrd, did you want to  
4 respond?

5 MR. BYRD: Just to say that what Arthur Rinsky  
6 stated is correct.

7 JUDGE ALDRICH: Thank you.

8 And since there was some testimony, CDTFA, did  
9 you want to ask any questions of Mr. Byrd in response to  
10 his statements?

11 MS. DANIELS: No. I don't believe we have any  
12 questions at this time. Thank you.

13 JUDGE ALDRICH: Okay. So at this time I'd like  
14 to transition to CDTFA's combined opening and closing.  
15 Are you prepared to proceed?

16 MS. DANIELS: Yes. Thank you, Judge.

17

18 PRESENTATION

19 MS. DANIELS: Good afternoon.

20 The matter before us originated from a Notice of  
21 Determination, which was issued by the Department on  
22 August 22nd, 2018, which included the following two audit  
23 items: One, disallowed claimed nontaxable labor sales in  
24 the amount of \$3,487,869, based on statistical samples;  
25 and two, unreported taxable sales of \$3,149 based on the



1 difference between tax accrued and tax reported.

2 Appellant filed a timely petition for  
3 redetermination, which was dated September 20th, 2018,  
4 disputing the liability in its entirety. By email, dated  
5 July 11th, 2019, Appellant confirmed that it was only  
6 disputing Audit Item 1 and conceded to the measure of a  
7 \$3,149 for Audit Item 2. The Department subsequently  
8 determined that some of the disallowed claimed nontaxable  
9 labor sales were not subject to tax pursuant to  
10 Regulation 1501.1.

11 As such, after a series of reaudits, deficiency  
12 in dispute now measures \$1,644,698. Thus, the only  
13 remaining issue in this case is whether Appellant's  
14 contracts currently dispute, i.e., the focused ion beam  
15 circuit edit services, herein collectively referred to as  
16 FIB Services, constitute qualified research and  
17 development contracts pursuant to Regulation 1501.1, and,  
18 if not, whether the services at issue constitute repair  
19 labor.

20 So California imposes sales tax on a retailer for  
21 its retail sales of tangible personal property in this  
22 state measured by its gross receipts, unless the sale is  
23 specifically exempt or excluded from taxation by statute.  
24 And that's Tax Code section 6051. All of a retailer's  
25 gross receipts are presumed subject to tax until the

1 contrary is established, and the burden of proving to the  
2 contrary is on the retailer. That's Tax Code section  
3 6091.

4 Gross receipts means the total amount of the sale  
5 price of a retailer's retail sales of tangible personal  
6 property, including the cost of labor or services, as well  
7 as any services that are part of the sale. And that's Tax  
8 Code section 6012 subdivisions (a)(2) and (b)(1). Gross  
9 receipts do not include the price received for labor or  
10 services used in installing or applying the property sold;  
11 Tax Code section 6012 subdivision (c)(3).

12 A sale means and includes the producing,  
13 fabricating, or processing of tangible personal property  
14 for a consideration for consumers who furnish either  
15 directly or indirectly the materials used in the  
16 producing, fabricating, or processing. And that's Tax  
17 Code section 6006 subdivision (b). Also, you can see  
18 Regulation section 1526 subdivision(a).

19 Fabrication includes any operation which results  
20 in the creation or production of tangible personal  
21 property, or which is a step in the process or series of  
22 operations resulting in the creation or production of  
23 tangible personal property; Tax Code section 6006  
24 subdivision(b). Fabrication does not include the mere  
25 repair or reconditioning of tangible personal property.

1 And that's Regulation 1526 subdivision (b).

2 Regulation 1501.1 governs a particular type of  
3 service enterprise, qualified R&D contracts. And it  
4 provides a two-part test to determine whether a particular  
5 transaction qualifies as nontaxable R&D for sales and use  
6 tax purposes. A transaction qualifies as nontaxable R&D  
7 only if one, the service is provided under agreement for  
8 the purpose of discovery information, which is  
9 technological in nature, the results of which are intended  
10 to be useful in the development of a new or improved  
11 product, process, technique, or invention; and two, the  
12 contract calls for the delivery of a report detailing  
13 information developed by the contractor or other tangible  
14 personal property incidental to the true object of the  
15 contract as defined in Regulation 1501 subdivision (a)(1).

16 A qualified research and development contract  
17 shall not include a contract for research for the purposes  
18 of improving a commercial product if the improvements  
19 relate to style, taste, cosmetic, or seasonal design  
20 factors. Nor does it include a contract for the design  
21 and production of custom-made item. A custom-made item is  
22 defined under subsection (a)(5) as to include one,  
23 property the purchaser wants for its intrinsic value as an  
24 item, and for which the purchaser is not interested in the  
25 data developed in the course of the manufacturer of the

1 custom-made item; two, property purchased for use by the  
2 purchaser or for resale; or three, tooling produced and  
3 used for the manufacturer of final production units.

4 R&D contracts may include a transfer of tangible  
5 personal property. Regulation 1501.1 explains when the  
6 transfer of TPP as part of an R&D contract is nontaxable,  
7 and it draws a distinction between tangible personal  
8 property transferred as a prototype, and tangible personal  
9 property transferred as a custom-made item. And you can  
10 see Regulation 1501.1 subdivision (a)(5). However, this  
11 distinction is relevant only when the item produced by the  
12 contractor is the result of the contractor's own R&D.

13 Where a contractor performs R&D to produce  
14 tangible personal property, the transfer of that property  
15 may be a nontaxable transfer of a prototype or may be a  
16 taxable sale of a custom-made item. And that's 1501.1  
17 subdivision (b)(2). Where instead the contractor produces  
18 TPP, based on R&D performed by its customer, it is simply  
19 making a sale of tangible personal property. Similarly,  
20 if a contractor fabricates a sample produced by its  
21 customer based on the customer's own R&D so that the  
22 customer can perform its own testing of its own R&D, the  
23 contractor is still simply fabricating tangible personal  
24 property for its customer, which results in making a sale  
25 of tangible personal property.

1           As such, if the property is not the result of the  
2     contractor's R&D, the transfer is a sale and is taxable,  
3     unless the sale is specifically exempt by statute. And  
4     that's Tax Code section 6006 subdivision (b). When a  
5     right to an exemption or exclusion from tax is involved,  
6     the taxpayer has the burden of proving his right to them.  
7     And that's Honeywell, Inc., v. State Board of  
8     Equalization, a 1982 case available at 128 Cal.App. 3rd  
9     739. See pages 744 to 745, also California Civil Code  
10    section 720360.

11           Any taxpayer seeking an exemption or exclusion  
12    from tax must establish that right by the evidence  
13    specified by the relevant regulation. A mere allegation  
14    that the sales are not subject to tax is not sufficient.  
15    And that's Paine v. State Board of Equalization, 137  
16    Cal.App 3rd 438 at 422, also Appeal of Talavera.

17           JUDGE ALDRICH: Ms. Daniels, one moment.

18           Mr. Rinsky and Ms. Rinsky, are you still  
19    connected?

20           Okay. Did you just turn off your camera?

21           MS. RINSKY: Yeah. I'm sorry. We -- we can  
22    keep it on if you prefer.

23           JUDGE ALDRICH: No. I just want to make sure that  
24    you're able to --

25           MS. RINSKY: Thank you for checking.

1 JUDGE ALDRICH: Okay. You can go back to mute.  
2 Thank you.

3 Ms. Daniels, please proceed. Sorry for the  
4 interruption.

5 MS. DANIELS: No problem. Thank you, Judge.

6 So as I was saying, a mere allegation that sales  
7 are not subject to tax is not sufficient. And that's  
8 stated in Appeal of Talavera, 2020 OTA 022P.

9 At the outset, we note that Appellant has not  
10 provided the Department with copies of any agreements or  
11 contracts that would help to decipher whether the services  
12 Appellant provided were exempt under Regulation 1501.1  
13 Appellant has provided purchase orders. But, again, these  
14 invoices do not provide the reason behind the services  
15 rendered to illustrate whether the services provided were  
16 done so to discover technical information, as a service,  
17 or to produce a custom-made item.

18 Furthermore, Appellant failed to provide any  
19 formal reports that it issued to its clients that would  
20 thus support that the services rendered were for the  
21 purpose of discovering specific information. However,  
22 even without a written contract or report, the Department  
23 still found that Appellant's charges for failure analysis  
24 were not subject to tax because the services were provided  
25 for the purpose of discovering information, which is

1 technological in nature, the results of which are intended  
2 to be useful in the development of new or improved  
3 product, process, technique, or invention. And the  
4 information was conveyed to the customer in the form of  
5 the returned sample.

6 The Department also found that Appellant's Decap  
7 and sample preparation services were not subject to tax  
8 because available evidence indicates that they were part  
9 of the failure analysis services. In contrast, the  
10 available evidence that the FIB Services were used to  
11 fabricate TPP provided by its clients according to their  
12 specifications and not a result of Appellant's own  
13 research and development.

14 So, specifically, FIB Services involve using a  
15 finely focused gallium ion beam with nano scale resolution  
16 to image, etch, and deposit materials on an integrated  
17 circuit. And that's available in our Exhibit A, page 29,  
18 which also is where Appellant states that this process is  
19 used to reroute connections within a device, as well as to  
20 create pro points for electrical testing in support of a  
21 customer's research and development process; the goal of  
22 which is to meet specified performance specifications for  
23 the subject product.

24 Importantly, Appellant has described its FIB  
25 Services as making a one-time modification to a customer

1 sample based on the customer specifications to improve the  
2 production or design process. For example, Appellant's  
3 petition for determination, available at page 35 of  
4 Exhibit A, states, quote, "Nanolabs gets its clients  
5 suggested modification/rewire instructions," end quote.  
6 Thus, these services are based on the client's instruction  
7 and not a part of Appellant's research.

8 The fact that Appellant performed these services  
9 based on its customer's request is consistent throughout  
10 its submissions and supports the Department's  
11 understanding that these were client directed fabrication  
12 and not part of a qualified research and development  
13 contract related to the failure analysis testing.  
14 Appellant has also provided summaries of its transactions,  
15 which support the Department's understanding. An example,  
16 this would be Exhibit B, pages 43 through 56.

17 At the outset of every summary of the  
18 transactions provided, it states that the customer  
19 provided the sample TPP, quote, "Along with a summary of  
20 the failures they experienced in the design changes they'd  
21 like to test," end quote. And that's Exhibit B, pages 43,  
22 48, and 53. Appellant then made these changes and  
23 subsequently returned the samples to its customer. And  
24 that's described at Exhibit B, pages 53 through 54. In  
25 some instances the sample would be sent back to Appellant



1 to perform further FIB Services pursuant to instructions  
2 stated on the invoice. Again, this is Exhibit B, pages 53  
3 to 54.

4 The Department's understanding that Appellant was  
5 fabricating items based on its client instructions and  
6 research is also corroborated by Appellant's second  
7 supplemental declaration of Mr. Byrd, which is Appellant's  
8 Exhibit 8. It states that the customer's property is  
9 resealed and returned to the client for secondary  
10 verification, and that resealing allows sufficient time  
11 for the client to further validate whether the property  
12 now works as intended by the client. This statement is  
13 clearly consistent with the Department's understanding  
14 that Appellant is fabricating these chips according to its  
15 client's specifications and then providing the chip back  
16 to its client for verification.

17 The evidence provided by Appellant constantly  
18 states that the FIB Services are rendered according to the  
19 client's instructions. If Appellant is providing services  
20 as ordered by its clients, these services are unlikely to  
21 be the result of research and development that was  
22 performed by Appellant. Accordingly, the FIB Services  
23 were not related to Appellant's research but to its  
24 client's research.

25 As to Appellant's arguments that the FIB Services

1       should be considered nontaxable repair labor, we disagree.  
2       Appellant has stated that the sample in question are  
3       generally, quote, "A wafer, chip, integrated circuit, PC  
4       board, electrical or mechanical component, or a physical  
5       material utilized by the customer as a tool for product  
6       development, engineering, or research." That's Exhibit A  
7       at page 18.

8               Appellant's website states that, quote, "Circuit  
9       editing allows our product designers to reroute conductive  
10      pathways and test the modified circuits in hours rather  
11      than the weeks or months that would be required to  
12      generate new masks and process new wafers," end quote.  
13      Exhibit A, page 26.

14             Accordingly, when Appellant utilizes its FIB  
15      Services to make design changes to a sample based on its  
16      customers instructions, it has performed fabrication on  
17      TPP furnished by the customer, which is subject to tax.  
18      This labor as described by Appellant is not analogous to  
19      the repair of an already functioning product. In this  
20      matter, Appellant has the burden to show that the FIB  
21      Services are not subject to tax pursuant to  
22      Regulation 1501.1. And the evidence present by Appellant  
23      does not show that it meets these requirements. The  
24      evidence shows that Appellant provides FIB Services that  
25      result in the creation or production of TPP. This is the

1 definition of fabrication.

2 The evidence also shows that the services  
3 provided are based on its client's instructions, rather  
4 than Appellant's own R&D. Accordingly, Appellant has not  
5 met its burden. For the foregoing reasons, no further  
6 adjustments are warranted to the taxable measure provided  
7 within the fifth reaudit, and we believe this appeal  
8 should be denied.

9 Thank you for your time.

10 JUDGE ALDRICH: Thank you.

11 Judge Ridenour did you have any questions for  
12 either of the parties?

13 JUDGE RIDENOUR: I do not. Thank you.

14 JUDGE ALDRICH: Judge Geary?

15 JUDGE GEARY: No. Thank you.

16 JUDGE ALDRICH: Okay. So at this time, I'd like  
17 to turn it back over to Mr. Rinsky for your opportunity to  
18 provide a rebuttal or a closing statement.

19 MR. RINSKY: Give us one second.

20 JUDGE ALDRICH: Do you need a moment to gather  
21 your thoughts?

22 MS. RINSKY: We're just having a muting issue,  
23 but I was -- the way to mute or unmute is away from where  
24 I'm sitting.

25 I guess -- well, I guess I -- with respect to the

1 Reg -- yeah.

2 JUDGE ALDRICH: Sorry. Just to be clear, are you  
3 prepared to proceed with your closing or rebuttal or.

4 MR. RINSKY: Yes, the rebuttal.

5 MS. RINSKY: The rebuttal.

6 JUDGE ALDRICH: Okay.

7

8 CLOSING STATEMENT

9 MS. RINSKY: Yeah. Well, --

10 MR. RINSKY: Leave it.

11 MS. RINSKY: -- what I initially presented still  
12 stands, even with what was presented. And I'm trying to  
13 think the best way to kind of -- if I want to try and  
14 clarify. There seems to be some sticking point, which is  
15 why at the end of my presentation I cited a couple of  
16 sections in the Regulation of 1501.1, so that's (a)(7),  
17 (a)(5), and (a)(6). And (a)(5) dealt with the custom-made  
18 items, and that specifically --

19 MR. RINSKY: Testing.

20 MS. RINSKY: Well, it deals with testing. And it  
21 says that custom-made items don't include property that  
22 the purchaser would use for information in testing  
23 purposes as defined in (a)(7). And I guess, I didn't --  
24 and then also, I'm trying to think the best way to explain  
25 it. I guess nowhere in the Reg does it say it has to be

1 R&D by contractor, by Nanolab. In a way that's almost a  
2 misstatement of the Reg because the whole -- because both  
3 parties are involved in the R&D process. So it's not one  
4 party is doing R&D and the other party is not.

5 And if you just look at the plain language of the  
6 Reg, it just simply states that there is a -- that these  
7 parties come together. There's a service provided under  
8 the contract that's undertaken for the purpose of  
9 discovering information. It doesn't say --

10 MR. RINSKY: That's what --

11 MS. RINSKY: It doesn't say there has to be R&D  
12 by the contractor, et cetera. It just says these parties  
13 come together to gather information, and the information  
14 will be technological in nature and the results are which  
15 is intended to use in development of a new or improved  
16 product, et cetera. And the fact that it says new and  
17 improved product, that in itself it shows that this Reg  
18 seems to have come into play to address the argument that  
19 the government is trying to make now.

20 And there would be no reason to have this Reg if  
21 the government is making a stand because it would just  
22 wipe out the whole Reg because they're not -- because if  
23 the argument is -- that's why it's just -- yeah. And I  
24 mean also, how the Reg is very clear that about functional  
25 use, that functional use is something that occurs after

1 completion of R&D if the R&D is ongoing process. It's  
2 still going on. This -- these items aren't for functional  
3 use. They oxidize. They don't work. They're in pieces.  
4 Even if they were whole, they aren't meant for functional  
5 use.

6 And as admitted by the government and explained  
7 in the affidavits by the engineers that do on -- that do  
8 the FIB circuit services, the whole purpose, the whole  
9 value of the service is to -- is to figure out what's  
10 going wrong -- what's going -- not working or improve the  
11 product. And it's for testing purposes as admitted by the  
12 government. And I think there was a sticking point early  
13 on that maybe when we ended up going to this whole tangent  
14 on the failure analysis service part was because there  
15 seems to be the sticking point of, well, who has to do the  
16 testing -- the information and testing.

17 But if you look at the Reg, it's very clear in  
18 the definition of the information and testing use in  
19 1501.1(a)(7) where it says that it includes use --  
20 information testing use by either the contractor or its  
21 customer. And it's also even stated again in the section  
22 on functional use in (a)(6), which says that -- that  
23 information and testing use of a prototype by the  
24 contractor, by Nanolab, or by its customer, does not  
25 qualify as functional use. So we're not dealing with a

1 final product that's just out there.

2 That makes sense.

3 MR. RINSKY: Makes sense.

4 MS. RINSKY: Yeah. But I think I addressed most  
5 of the arguments. So I don't think there's more, unless  
6 there's any questions from the Judges. Unless --

7 MR. RINSKY: I have a couple of comments.

8 MS. RINSKY: Okay.

9 MR. RINSKY: Number one, I think the Respondent  
10 has been a bit disingenuous on the whole fabrication  
11 argument. I gave you a case cite that defines that --  
12 that this -- that the OTA has come up with. And it says  
13 changing the intended purpose or use. The Respondent has  
14 not shown that that's -- that's what occurred in these  
15 transactions. We have the affidavits and declarations  
16 saying that's not what happened. We did not change the  
17 intended purpose or use. So I think the fabrication  
18 argument, there's no evidence from -- that contravenes  
19 what we've put forward that says this -- this is not  
20 fabrication using OTA's own definition.

21 I think number two, the whole contract issue, to  
22 me, is kind of a red herring in the sense it was dealt  
23 with through the appeals process. I would like, as a  
24 lawyer, that they would do a re -- R&D contract that would  
25 have recitals and background and all that kind of stuff,

1       which is what lawyers like. That's not the business, and  
2       Thomas could speak to that. The business is we get the  
3       purchase order. Then they go back and forth and they  
4       don't waste money on lawyers because they don't make any  
5       money when they involve lawyers in the process. That's  
6       just not the way the business works, the business that  
7       they're in.

8               And, finally, the idea that the FIB Edit is based  
9       on instructions from the client, if the client knew how to  
10      do all this, they wouldn't pay us. These are suggestions.  
11      We try it, and I bet they don't work a lot of times.  
12      Thomas can speak to that because they go back and forth  
13      with the client trying to figure out why the item isn't  
14      working. Because if the client knew why it wasn't  
15      working, they wouldn't be paying us. So I think the whole  
16      idea that we're doing this based on their instructions is  
17      just a red herring, besides ignoring the Regulation  
18      1501.1.

19             And that's the total of our rebuttal. I don't  
20      know if you --

21             JUDGE ALDRICH: Thank you, Mr. Rinsky.

22             To summarize on the contract issue, you're not  
23      saying that there was just an agreement or that there  
24      wasn't a contract. You're saying that there were  
25      contracts but perhaps not as formally robust as an



1 attorney might like.

2 MR. RINSKY: Yes, that's exactly the case.

3 And -- and --

4 JUDGE ALDRICH: So, Mr. Byrd, to clarify, you  
5 know, the basic elements of a contract have been met  
6 between the client and the Appellant, such that there's  
7 offer, acceptance, consideration, and things like that,  
8 just they're not as robust as, you know, Mr. Rinsky would  
9 prefer. Would that be accurate?

10 MR. BYRD: Yes.

11 MS. RINSKY: Wait. Because I don't know if  
12 not -- objection to this. But the contract, whether or  
13 not there's a contract isn't at issue. I don't think  
14 that's what Arthur was trying to -- I mean, I don't think  
15 that was the point of what he was trying to convey. It  
16 was just that -- that the CDTFA is looking for something  
17 that's not going to hap -- that's not going to happen in  
18 business.

19 Because what happens is the client has a problem  
20 with something, or they're trying to work on something,  
21 create something. It's not working right, the way it is  
22 intended to work. And so then they send this purchase  
23 order that says, hey, we need these services. And it is  
24 understood that FIB Circuit Edit is a failure analysis  
25 service. It's in the textbooks. It's in -- it's what

1       they do. So when they see that, they go, okay, we are  
2       going to now provide this service. And that's kind of how  
3       it is, if that makes sense.

4               I just want to say we weren't trying to -- the  
5       contract issue isn't actually at issue. I don't know what  
6       you're going to ask Mr. Byrd, but -- about contracts, but  
7       our understanding is that whether or not there is a  
8       contract wasn't at issue. It's more just whether --  
9       whether there is --

10              MR. RINSKY: There -- there is a contract. It's  
11       just in their business the contract is not the standard  
12       way I'd like to see it with recitals, background, all the  
13       other stuff, dispute resolution and everything else in a  
14       nice long document.

15              JUDGE ALDRICH: Okay.

16              MR. RINSKY: They get the purchase order, and  
17       then they go back and forth trying to figure why this  
18       thing isn't working. Not trying to change it, not trying  
19       to make it different, or do anything different, just try  
20       to figure out why it isn't working.

21              MS. RINSKY: Or -- or -- this is Lauren speaking  
22       again. It -- it's not like there's a contract that says,  
23       we are here joined together to create. You know, it's not  
24       going to follow the Reg is what we're saying. It's not  
25       going to follow the Reg.

1 MR. RINSKY: Formally.

2 MS. RINSKY: Yeah, formally follow the Reg. It's  
3 not going to say, oh, we are hiring you to undertake a  
4 service to discover information that's technological in  
5 nature. It's not going to say that. And I just want  
6 to --

7 JUDGE ALDRICH: Okay. Thank you for that  
8 clarification.

9 I think we are about ready to conclude the  
10 hearing. The record is not closed. We have some  
11 additional housekeeping matters to address after the  
12 conclusion of this hearing, which will be handled with  
13 some post-hearing orders. As I mentioned, you know, if  
14 either of the parties need our assistance, they can make a  
15 request for a post-hearing meeting. But that request  
16 needs to be in writing and with a stated purpose.

17 With that said, thank you everyone for your time  
18 today. We're ready to end the recording, I believe.  
19 Okay.

20 (Proceedings adjourned at 2:38)

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I, Ernalyne M. Alonzo, Hearing Reporter in and for  
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That the foregoing transcript of proceedings was  
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I further certify that I am in no way interested  
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I have hereunto subscribed my name this 15th day  
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