



State of California Office of Tax Appeals

June 29, 2023

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Request for Attorney General Opinion **Government Code section 12519**

Dear Mr. Nolan:

Pursuant to Government Code section 12519, the Office of Tax Appeals (OTA) requests that the Attorney General issue a written opinion on the following question of law.¹ The background facts are clear and undisputed.

Legal Question Presented to the Attorney General

The specific question presented is as follows:

1. Does OTA have the legal authority and jurisdiction to issue a written opinion² declaring a provision in the California Code of Regulations, which was promulgated by a different state agency and approved by the Office of Administrative Law, to be invalid and to refuse to enforce the regulation on that basis?³

¹ OTA has authority to make this request because it is not under the jurisdiction of the Government Operations Agency, or any other state agency. (See Gov. Code, § 15670.)

² OTA is required to publish a written opinion for every appeal decided. (Gov. Code, § 15675.)

³ OTA has, to date, never issued a written opinion with such a holding. For purposes of this request, assume that a court of competent jurisdiction has not declared the regulation in question to be invalid, and there is no pending litigation involving such a matter in any court of competent jurisdiction.

Background and History

OTA is the statutory successor to the State Board of Equalization (Board). Prior to July 1, 2017, the Board conducted administrative appeals concerning tax disputes between the taxpayers and the Franchise Tax Board (FTB), and other various tax appeals between taxpayers and other state agencies. The Board issued precedential decisions deciding some of these appeals.⁴

The State Board of Equalization⁵

The Board issued two precedential decisions where a taxpayer presented a challenge to the validity of a regulation promulgated by 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 invalid. In reaching such a determination, the Board applied a judicial standard of review used by the California appeals 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 consisting of: (1) a determination of whether the regulation is interpretative or quasi-legislative, and (2) the application of a standard of lesser judicial deference to an interpretative regulation (as defined by the court), while retaining the higher judicial standard of review 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* effectively overturned the Board's precedential decision in *Standard Oil*. In *Standard Oil* the Board adopted the judicial standard of review of a regulation as the Board's own standard of but 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. The precedential status of *Standard Oil* was never removed.

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). 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). 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

⁴ OTA has authority to remove the precedential status of a Board opinion. (See Cal. Code Regs., tit. 18, §§ 30503, 30504.)

⁵ The Board is a constitutional body created by the California Constitution, and the members of the Board are statewide officials elected by district.

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.⁶

The California Legislative Counsel Opinion

Following the Board's decision in *Save Mart*, Senate Revenue and Taxation Committee Chairman Gil Cedillo requested a written opinion from the California Legislative Counsel, addressing whether the Board had authority to overturn the regulation in question. According to a news article (Attachment 1) summarizing the Legislative Counsel's 15-page written Opinion (#18456), the Legislative Counsel concluded that: (1) there was no statutory authority for the Board to hold that a regulation adopted by FTB is invalid; (2) the Administrative Procedure Act provides to the Office of Administrative Law the exclusive procedure to adopt, amend, and repeal a regulation; and (3) "that the [Board] does not act in a judicial capacity in interpreting a franchise and income tax regulation."

The Office of Tax Appeals

The Taxpayer Transparency and Fairness Act of 2017 (Stats. 2017, Ch. 16), as amended by Assembly Bill 131 (Stats. 2017, Ch. 252), collectively referred to hereinafter as "the Act," created OTA effective July 1, 2017. The Act transferred to OTA the various duties, powers, and responsibilities of the Board necessary or appropriate to conduct appeals hearings, except for those duties, powers, and responsibilities imposed or conferred upon the Board by the California Constitution. (See Gov. Code, § 15600, subd. (a).)

As of January 1, 2018, OTA is the successor to, and is vested with all the duties, powers, and responsibilities of the Board necessary or appropriate to conduct appeals hearings with respect to tax and fee programs that were previously the duties, powers, or responsibilities of the Board. (Gov. Code, § 15672.) The laws establishing and governing OTA are 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, subd. (a).)

OTA's jurisdiction includes hearing appeals of tax and fee programs administered by various tax agencies and as set forth in Government Code section 15671. OTA also hears appeals from the California Department of Tax and Fee Administration (CDTFA). The Board never opined, in a precedential decision, on the standard of review of a regulation promulgated by CDTFA.⁷

⁶ In *Save Mart*, the Board reached the "conclusion that Regulation section 23649-3 is invalid." FTB promulgated California Code of Regulations, title 18, section 23649-3 with an operative date of May 31, 1993. (Register 93, No. 18.) The only authority cited for FTB's regulation is Revenue and Taxation Code 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 Revenue and Taxation Code.

⁷ The Board only reviewed CDTFA decisions for a six-month period from July 1, 2017, until December 31, 2017. (Gov. Code, § 15600, subd. (d)(2).) Prior to this timeframe, the 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, cannot refuse to follow its own regulations. (*Newco Leasing, Inc. v. State Bd. of Equalization* (1983) 143 Cal.App.3d 120, 124.)

The Legislature specified in statute that OTA's tax panels shall not be constructed to be a tax court. (Gov. Code, § 15672, subd. (b.)

The Proposed Regulatory Action

During a proposed regulatory action, OTA noted legal uncertainty concerning whether OTA has jurisdiction or authority to invalidate provisions in the California Code of Regulations that were promulgated by another state agency. OTA then determined that it lacked such authority for the reasons noted below (see "Legal Analysis,"). OTA proposed language similar to the following:

Proposed Regulation at Issue. OTA does not have jurisdiction to determine whether an Agency's regulation contained in the California Code of Regulations is invalid and refuse to follow the regulation on that basis.

OTA held a public hearing regarding the adoption of proposed amendments to California Code of Regulations, title 18, division 4.1, OTA's Rules for Tax Appeals, which, in pertinent part, included amendments to Proposed Regulation 30104.⁸ Interested Parties submitted public comments objecting to the changes concerning jurisdiction (Attachment 2).⁹ In addition, the media published several articles addressing the proposed jurisdiction amendments. In response, OTA removed the proposed changes from the rulemaking process for further consideration.

Legal Analysis

Does OTA have the legal authority and jurisdiction to issue a written opinion declaring a provision in the California Code of Regulations, which was promulgated by a different state agency and approved by the Office of Administrative Law, to be invalid and to refuse to enforce the regulation on that basis?

OTA lacks the statutory authority and jurisdiction to issue a written opinion declaring a provision in the California Code of Regulations to be invalid or to refuse to follow such a provision on the basis for the following reasons: OTA is not a court and sits in a fundamentally different position than its predecessor the Board; the Administrative Procedure Act is the only appropriate method for overturning a duly enacted regulation; OTA has not been conferred the power to overturn a duly enacted regulation; and an administrative agency cannot refuse to follow a regulation.

⁸ The rulemaking documents are available for download at <https://ota.ca.gov/regulations/>

⁹ This attachment comprises public comments received from interested parties. The legal bases for the objections are varied. The primary concern raised is that the Board exercised jurisdiction to invalidate such regulations, and OTA has the same powers as the Board and the duty to hear all appeals. As such, the concern is that OTA's purported abdication of jurisdiction would unfairly favor agencies because a taxpayer's only other remedy is to seek invalidation in court.

OTA is not a court and sits in a fundamentally different position than its predecessor the Board due to its nature as an administrative agency.

Although OTA's predecessor, the Board, purportedly held the authority to invalidate the regulation of a sister agency, it does not follow that OTA holds the same authority. 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 two different judicial standards of review. The fundamental changes in the law relate to the review structure for administrative tax appeals. When OTA was created the Legislature made clear that OTA stood in a different role and structure than did the Board. The Board's ability to act in a judicial capacity was unclear because of its nature as a constitutional body; however, the Legislature clearly declared that OTA is not a court. Accordingly, OTA cannot act in the judicial capacity the Board did when striking down the regulations at issue in *Standard Oil* and *Save Mart*.

Furthermore, OTA cannot be a court or exercise the authority of the court because it is a legislatively-created administrative agency. Under Section 1 of Article III of, and Section 1 of Article VI of, the California Constitution, the Legislature may not ordinarily confer judicial functions upon any statewide administrative agency which the Legislature has created, unless the Constitution itself has authorized the creation of an agency and also has authorized the Legislature to vest judicial powers in that agency. (*Perry Farms, Inc. v. Agricultural Labor Relations Bd.* (1978) 86 Cal. App.3d 448, 460). Here, the California constitution confers no such authority, and, unlike the Board, OTA is not a constitutional body. Thus, the Legislature specified in statute that OTA's tax panels shall not be constructed to be a tax court and conferred no judicial functions on OTA. (Gov. Code, § 15672, subd. (b).) It follows that, the proper jurisdiction to address a challenge to the validity of a regulations is in a court of competent jurisdiction as opposed to an administrative agency such as the Office of Tax Appeals. (See, e.g., Gov. Code, § 11350.)

Accordingly, 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. The body reviewing challenged regulations is no longer a constitutional body comprised of elected officials, but is an administrative agency specifically designed by the Legislature not to be a court. As such, OTAs authority cannot be the same authority the Board purportedly held when it declared that it was applying a judicial standard of review and found the regulations at issue in *Standard Oil* and *Save Mart* to be invalid.

The Administrative Procedure Act is the only appropriate method for overturning a duly enacted regulation.

The Administrative Procedure Act (APA) contains a comprehensive procedure for the adoption, amendment, and repeal of regulations by state agencies. (Gov. Code, § 11340 et seq.) However, nothing in the APA authorizes a state agency, or augments the authority of any state agency, to adopt, administer, or enforce any regulation. (Gov. Code, §§ 11342.1, 11342.4.) To the contrary, the law expressly provides that the APA "shall not be superseded or modified by any subsequent legislation except to the extent that the legislation shall do so expressly." (Gov. Code,

§ 11346.) Thus, the APA provides the exclusive procedure for the adoption, amendment, repeal, administration, or enforcement of any regulation. Allowing OTA to invalidate another state agency's regulations would improperly supplant the authority conferred upon the Office of Administrative Law under the APA.

OTA has not been conferred the power to overturn a duly enacted regulation.

Administrative agencies have only those powers that have been conferred on them, expressly or by implication, by constitution or by statute. (*City and County of San Francisco v. Padilla* (1972) 23 Cal. App.3d 388, 400.) An administrative agency, therefore, must act within the powers conferred upon it by law and may not validly act in excess of those powers. (*Ibid.*) It is well settled that when an administrative agency acts in excess of, or in violation of, the powers conferred upon it, its action thus taken is void. (*Ibid.*) Here, there is no constitutional or statutory authority that expressly supersedes or modifies the authority of the Office of Administrative Law under the APA, or that would otherwise authorize OTA to repeal or revise a regulation adopted by another state agency.

An administrative agency cannot refuse to follow a regulation.

An administrative agency cannot refuse to follow its own regulations. (*Newco Leasing, Inc. v. State Bd. of Equalization* (1983) 143 Cal.App.3d 120, 124; see Gov. Code, § 15672.) To the contrary, an agency may not alter a regulation except pursuant to the statutory process set forth under the APA. (*Motion Picture Studio Teachers & Welfare Workers v. Millan* (1996) 51 Cal.App.4th 1190, 1195). "The ultimate resolution . . . of whether [the agency] has correctly interpreted the statutes and its regulations rests with the courts." (*Ibid.*) As discussed above, OTA is not a court. Even an agency promulgating a regulation cannot invalidate a regulation, except through the process set forth in the APA. By extension, there is no authority granting OTA jurisdiction to invalidate another agency's regulations outside of the process authorized in the APA.¹⁰

Conclusion

In summary, OTA is an administrative agency and OTA is 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.) Similarly, the authority to declare a provision of the California Code of Regulations invalid rests with the judiciary, and OTA lacks such authority. (See Gov. Code, § 11350, subd. (b).)

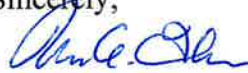
For all the reasons summarized above, the current statutory framework does not authorize OTA to declare, in a written opinion resolving a tax appeal between another state agency and a taxpayer, that a provision in the California Code of Regulations is invalid. OTA is requesting a written opinion to guide OTA regarding the scope of its jurisdiction and whether the proposed regulatory

¹⁰ As an exception, an Agency might be able to conclude that its own regulations are invalid in its own internal administrative appeals process. (*Woods v. Superior Court* (1981) 28 Cal.3d. 668.)

amendments are consistent with state law. This is an important issue for stakeholders, the regulated public, and tax agencies subject to the jurisdiction of OTA, including FTB, CDTFA, and various other state agencies whose taxes and fees are administered by CDTFA. OTA is committed to fully exercising the powers conferred upon it to act as an independent forum to hear appeals from California taxpayers who have disputes with various tax agencies, while recognizing the limitation of the powers that have been conferred to it. It is OTA's position that it lacks the jurisdiction or authority to invalidate, by written opinion, a duly promulgated provision in the California Code of Regulations.

We look forward to discussing this request with you and your staff. Please feel free to contact me at 916-206-3344, or OTA's Chief Counsel, Kristen Kane, at 916-206-0792.

Sincerely,



Mark A. Ibele, Director
Office of Tax Appeals

Attachments: Attachment 1 – Article Regarding Legislative Counsel Opinion
Attachment 2 – Public Comments on Proposed Regulation

MI: pdl

cc: Kristen Kane, Chief Counsel, Office of Tax Appeals
Myriam Bouaziz, Chief Deputy Director, Office of Tax Appeals