

GeTtin' SALTy Podcast – Episode 59

Speaker 1 ([00:01](#)):

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Shail Shah ([00:17](#)):

It is a really big win, and it was a little surprising given the history I mentioned a few minutes ago. It's surprising for that reason. It's also surprising based off the way the OTA made the request.

Nikki Dobay ([00:35](#)):

Hello, and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Sacramento, California, and Portland, Oregon offices. We are going to get a California update today with always a mouthful shareholder Shail Shah out of the San Francisco office. Shail, thank you so much for being here today to talk about that giant state that we all love, California.

Shail Shah ([01:05](#)):

Glad to be back on, Nikki.

Nikki Dobay ([01:07](#)):

All right, so let's start with some big news. There was an AG opinion, which we don't usually focus on, but the California AG released an opinion about the Office of Tax Appeals. It's not a jurisdictional question per se, but it definitely impacts what they can do with respect to cases, so catch us up on that.

Shail Shah ([01:30](#)):

Yeah, it's the age-old question in California on what tax administrative agency has the authority to do. There's all these age-old questions in California, is NorCal better than SoCal? Dodgers vs. Giants, and then-

Nikki Dobay ([01:47](#)):

And then this one.

Shail Shah ([01:48](#)):

And then this one. Yeah, so this was AG Opinion 23701. And to your point, Nikki, there are not a lot of AG opinions that weigh in on tax jurisdictional issues, but this was one of them. And it dealt with a fairly narrow question. It was whether the OTA has the ability to effectively say that a regulation trumps a statute. And I'll go into the background how we got here, but the punch line, and the short answer is, the AG said, "Yes, you can. It is within the jurisdiction of the OTA." There's a conflicting regulation in a statute they can decline to apply the regulation.

([02:33](#)):

So, this was a big deal, because, as I think a lot of our listeners probably know, a lot of tax cases don't go to litigation in California. The vast majority of them are resolved, especially the more contentious ones are resolved at the Office of Tax Appeal. And so, the ability for taxpayers to now argue that there's a regulation and there's a statute and they both conflict, and to have the OTA weigh in on whether the

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statute or the regulations should apply is big, because there's obviously, California is a big state, a lot of regulations and a lot of statutes.

Nikki Dobay ([03:12](#)):

So, now the Office of Tax Appeals is still fairly new, came in about 2017, 2018. So, prior to this it was the Board of Equalization that would review these cases. So, their powers got transferred to the OTA. Could they say that the regulation was inconsistent and therefore rule in favor of a taxpayer? Was this a question that lingered before the BOE prior to the OTA being put in place?

Shail Shah ([03:45](#)):

Well, it's unfortunately not a straightforward answer.

Nikki Dobay ([03:48](#)):

All right. That's why we're here, to give the not straightforward answers.

Shail Shah ([03:52](#)):

I'll give you the path there.

Nikki Dobay ([03:53](#)):

Sure.

Shail Shah ([03:53](#)):

The BOE historically did apply on whether a statute would trump a regulation. What was interesting though was while ... There's a few cases in California under the old Board of Equalization where the BOE did exactly that. The Board of Equalization, similar to what the OTA did here, actually back in the early 2000s requested an attorney general opinion on whether they had the authority.

Nikki Dobay ([04:25](#)):

This sounds familiar.

Shail Shah ([04:26](#)):

It is. Interesting enough, the Attorney General said no, that the Board of Equalization did not have the authority, but it was a non-binding opinion by the attorney general's office. So historically, there's about three or four cases where the BOE agreed with the taxpayer that a regulation applied, or sorry, a statute applied over a regulation. But the AG's office, at least at that time didn't think that the Board of Equalization had that authority.

Nikki Dobay ([04:55](#)):

And I will say, this is, I mean, you went to law school. I went to law school. A lot of our listeners went to law school. This is a weird thing for me to think about. Of course, the statute trumps the regulation. That's what we learned in law school. When I was reading the opinion, and I'm always looking into California as an outsider, so I'm often confused or outraged by how everything works there, but it just seemed like such an obvious answer that the AG got to. Of course, if a regulation is an overreach beyond the scope of the statute it should not be followed. I thought the other question, "Could they invalidate a

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regulation?" That's kind of another interesting question, and there the answer was no. And I suppose that's, it is always hard with these independent tax tribunals to understand, are they judicial? Is it an agency? And so, I guess in California the OTA is clearly part of the executive branch. Is that, that's kind of where things come down?

Shail Shah ([06:03](#)):

Yeah, that's correct. And the threshold question for the AG was whether ... The OTA said that a statute trumps a regulation, is that quasi-legislative or is it quasi-adjudicative? And what the AG's opinion said was, "Look, this is an adjudicative body, so it is within the purview of the OTA to apply a statute of regulation." But to your point, Nikki, invalidating regulation would be, at least in the view of the Attorney General, that would be a quasi-legislative authority.

Nikki Dobay ([06:36](#)):

But the court, an actual court can still do that?

Shail Shah ([06:42](#)):

An actual court absolutely can.

Nikki Dobay ([06:45](#)):

Okay. So, a taxpayer can, and again, also, I think a bit of an oddity with the OTA is you can't appeal from an OTA decision. But if a taxpayer were to go to court and say that the regulation was invalid because it was inconsistent with the statute or broader, the agency had gone beyond the scope of its authority, that's still something the court can do?

Shail Shah ([07:11](#)):

Absolutely, yeah.

Nikki Dobay ([07:15](#)):

From your perspective as a California controversy litigator in this area, this is a pretty big win for taxpayers.

Shail Shah ([07:27](#)):

It is a really big win. And it was a little surprising given the history I mentioned a few minutes ago. It's surprising for that reason. It's also surprising based off the way the OTA made the request, so this was under the prior director, Mark Ibele-

Nikki Dobay ([07:42](#)):

Okay.

Shail Shah ([07:43](#)):

... who sent the request to Attorney General. And it was very much framed in a way where the OTA argued that it did not have the authority to make this decision. And at the end they said, "Are we right or are we wrong?" And it was a fairly slanted request by the OTA. And given that sort of slant, I think most practitioners that were following, and it took a few years by the time the AG issued the opinion, I

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think most practitioners felt that the AG was going to effectively decide the same way it did in the early 2000s that OTA does not have the authority.

Nikki Dobay ([08:26](#)):

I was going to ask how long it had taken, because I have a distant memory of when this was requested. And it was some time ago, so it's been a while. And did other people weigh in? Did practitioners weigh in? Were there counter arguments that were submitted to the AG on this issue?

Shail Shah ([08:45](#)):

I don't believe there was. Where we saw most of the practitioners push back, and this was an important piece of the chronology here, is that prior to the OTA requesting the opinion from the Attorney General they actually proposed regulations that said exactly this, that under the proposed regulations it explicitly said the Office of Tax Appeal does not have the ability to apply a statute over regulation where there's a conflict. And there was a significant amount of pushback from the taxpayer community on those proposed regulations. And for a large part, and I think rightfully so, there was nothing in the governing law that established the Office of Tax Appeal, which it was inherited from the Board of Equalization. There's nothing in there that actually explicitly prevented the Office of Tax Appeal from making those decisions. So, prior to the request to the AG the proposed regulations were pulled, given the feedback from the taxpayer community, and that prompted the request to the AG's office.

Nikki Dobay ([10:02](#)):

I see. Okay, okay. Yeah, that's interesting. And I don't know what the process, it may not even be something that anyone can just submit things. I do, like in Oregon I think it is an agency that has to request an opinion from the AG. Well, that's some pretty interesting history, and I guess we'll see how the ALJs respond to this going forward. But I feel like this is part of this broader question we've been having amongst a lot of states on deference. Because if the OTA had to follow regulations, even when they were inconsistent with the statute, which I don't even know how you do that, that kind of makes my brain explode. But that would automatically give the FTB so much deference. And we know that the California process for getting a reg in place is very long and arduous, so it's not as if they can just snap their fingers and put a regulation in place and have deference and win. But it just seems really counterintuitive that the OTA would have had to follow a regulation that was contrary to the statute. So, I'm glad we've nailed this down.

Shail Shah ([11:11](#)):

And I think that was one of the things that a lot of taxpayers were upset about. And there was a lot of people throwing out the phrase of underground regulations and the FTB having unfettered authority to make law without going through the legislative process. And I will say, this opinion is fairly narrow, so it applies for individual cases. For example, if the OTA decides that a particular regulation conflicts with the statute and in a particular case it decides to apply the statute, that doesn't necessarily mean in the next appeal you could have the exact same issue. It doesn't mean that they have to reach the same conclusion. Anyhow, practically speaking, they probably will. But there isn't a sort of a broad base decision where if a statute and a regulation conflict with one another.

Nikki Dobay ([12:06](#)):

Yeah, I mean, that goes to the second piece where the AG said they can't invalidate a regulation. Because that would be kind of the next step there, that the regulation would be invalidated and then it

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wouldn't apply across the board. But pretty interesting stuff out of California. You guys always surprise me. I don't know.

Shail Shah ([12:27](#)):

I think it's going to be interesting, and I think one of the things we'll probably start seeing a lot more of is, California has these special industry regs. A lot of them are adopted wholesale from the MTC, and they're nested within the alternative apportionment statute in California. And I think we're going to start seeing a lot of arguments that some of those special industry regs, which may conflict with the market-based sourcing statutes shouldn't apply. And it'll be interesting to see the different types of industries that are going to bring those cases forward, but-

Nikki Dobay ([13:03](#)):

I can give you a preview of that, because we're seeing that unfold at the MTC as we speak, so yes. Well, that's a pretty significant update. But California, the legislature is still in session. They've got about three weeks left. September 12th is their cutoff date. Catch us up on the tax front. California is making the news for some other reasons lately with respect to legislation. But I guess my questions for you, should we expect to see anything on the tax front, or is all this other stuff going to suck the air out of the room with respect to a few of the bills that we're moving?

Shail Shah ([13:48](#)):

Well, the way it works here in California is you'll see a flurry of tax bills. And for the most part most of them just die in committee. The one that has reared its head, and I think for the most part most people consider this a positive development is the conformity bill. And that's Senate Bill 711. And this would, so right now California conforms to Internal Revenue Code as of January 1st, 2015.

Nikki Dobay ([14:18](#)):

What are you going to do when you don't have to say that anymore? We're going to have to reprogram you.

Shail Shah ([14:23](#)):

I know. I'm going to shed a tear probably, but I don't have to say that anymore. It is now going to move the conformity date to January 1st, 2025. Now, obviously Obaba or OBBBA, whatever-

Nikki Dobay ([14:39](#)):

OB3, OBBBA, whatever you want to call it,

Shail Shah ([14:40](#)):

... just passed. So, 1125 is, I guess sort of old news now. It does bring California forward about a decade. The bill has not passed.

Nikki Dobay ([14:53](#)):

Okay. It passed the Senate.

Shail Shah ([14:55](#)):

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It passed the Senate.

Nikki Dobay ([14:56](#)):

Okay.

Shail Shah ([14:57](#)):

But all indicators point to the fact that it probably will pass. We don't see, we're not seeing any obstacles. There is, I think you were mentioning before, some other noise in California. I mean, obviously, Newsom on social media and everywhere else is talking about redistricting in California.

Nikki Dobay ([15:21](#)):

That's a tough one, yeah.

Shail Shah ([15:24](#)):

It is a tough one. And so, that is sort of sucking a lot of the media air out here in California. But I think that the Conformity Bill will pass, and I think most taxpayers are looking forward to this bill. Even though it doesn't necessarily provide a lot of the changes that we saw from Congress this year it will make, I think compliance a lot easier, and especially around depreciation, R&D credits and some of those factors.

Nikki Dobay ([15:54](#)):

They also just seems like a lot on the personal income tax side that really needs kind of a reset. This is not a space we spend a lot of time in, but you hear the software folks like, "Can we get this done? Because it just creates a lot of complexity there." And I'm not hearing any other noise on, and it's one of these things, you don't really want to say it out loud, but any super bad ideas that have been talked about over the last couple of years, it seems like conformity is really the tax issue that's front and center and what is expected to go. And otherwise it should be pretty quiet on the tax front.

Shail Shah ([16:39](#)):

Every spring we hear those 1,000 bad ideas, and then everyone-

Nikki Dobay ([16:43](#)):

And there's hearings and-

Shail Shah ([16:44](#)):

There's hearings.

Nikki Dobay ([16:45](#)):

Everybody gets excited.

Shail Shah ([16:47](#)):

Yeah, taxpayers are panicking. And then by the time it goes through this filtration system, most of those die. And we hear about service, sales tax on services, and we hear about wealth taxes and we hear about all these other bad ideas.

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Nikki Dobay ([17:03](#)):

25% corporate income tax rates, something wacky.

Shail Shah ([17:05](#)):

Exactly, right. And most of those just end up dying, thankfully.

Nikki Dobay ([17:12](#)):

Okay, okay. All right, so here's to a smooth sailing into the end of session on the tax front with conformity passing and everything else just falling by the wayside. And then the last update that I wanted to check in with you on is the litigation over the 2024 Budget Bill, SB 167. We've been working on the NTU case. Cal Tax also has a case. And so, catch the listeners up on, it's been a little quiet on that front, but we have a hearing date coming up at the end of next month. What should folks expect with respect to this case?

Shail Shah ([17:55](#)):

We have the cross motions for summary judgment hearing on September 30th. This will be both Cal Taxes, Franchise Tax Board, and NTU's motions will be heard on the same day. And it's the legal question on a substantive issue, which is whether the retroactivity violates the U.S. and California constitution. And then we have the other issues. NTU also argued that the statute is unconstitutionally vague, both internally vague and then also the way it conflicts with other statutes. And the Cal Tax argued the one subject rule, they also argued the separation of powers. And so, I think you'll see the substantive issues argue, but there's also procedural issues. I think we've talked about this before on the pod and our webinars as well, is that you have the standing issue and whether associations, both NTU and Cal Tax, our associations, have the ability to bring this lawsuit.

([18:55](#)):

And then also there's kind of a California constitutional issue under Section 32 of the California constitution. Whether associations are able to bring this over lawsuit and does that violate Section 32, which is a provision in the California constitution that prevents taxpayers from enjoining taxing agencies from carrying out their constitutional duties. So, there's going to be a lot of meat. I think it's going to be a very interesting and very important hearing on the 30th.

Nikki Dobay ([19:22](#)):

All right. Well, we better be ready to go. So, we will be. We should expect though a decision from the court pretty much right around that time, so this is one area where California moves very quickly. And then I think it's anticipated that no matter what happens at this hearing, the loser on whatever topics will be appealing. So, a really important hearing, I think a big decision to come out, but definitely not at the end of the road. I don't think so.

Shail Shah ([19:55](#)):

Not at the end of the road, right.

Nikki Dobay ([19:57](#)):

Yeah. All right, Shail, any other updates? The market-based sourcing rules were filed, so does that mean they're done?

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Shail Shah ([20:06](#)):

Yeah, that's actually, I'm glad you brought that up. It is the eight-year sag. I think it's eight, I sort of lose count after a while.

Nikki Dobay ([20:13](#)):

I mean, you guys in New York should have a competition, like who takes the longest to draft regulations.

Shail Shah ([20:19](#)):

Yeah, yeah. We're high technology, high-pace states that move very, very slowly when it goes through the regulation process. But the 25136-2, which is the market-based sourcing regs, are now officially with the Office of Administrative Law. And so, what that means, and California has a very complicated regulatory approval process, but this means once the OAL looks at the regulation and they sign off on it, and they have 30 days from the time it's submitted to either send it back to the department or sign off on it, it's officially a regulation. And one of the reasons agencies will go through a very lengthy interested party meeting is to prevent the OAL from kicking it back. Because what that does is then it brings that regulation on the bottom of the queue, and then they got to work their way up again. So, eight years is excessive, but parts-

Nikki Dobay ([21:21](#)):

I hope the examples are still relevant. That's always what I think about. It's like-

Shail Shah ([21:26](#)):

Yeah, well, especially in the age of AI and everything they're probably not relevant anymore, but-

Nikki Dobay ([21:31](#)):

Let's not say that.

Shail Shah ([21:33](#)):

Those regulations should be ready to go hopefully in the next 30 days.

Nikki Dobay ([21:39](#)):

All right. Okay, any other California updates for the listeners? It's a big state.

Shail Shah ([21:46](#)):

It's a big state. The last thing I'll mention, another one where it's been going on forever is the TTA on sales tax and technology transfer agreements. And that is whether embedded intangibles, intangible or personal property, and how do you divide and pull out those intangibles, sort of the non-taxable piece and the taxable piece. And there is another round of hearings on the TTA, and the decisions, the Nortel decision and a few other decisions that came out on that case came out a while ago, and so this is still going.

Nikki Dobay ([22:24](#)):

This one's been going on, I think longer than eight years. Because I remember being a very eager cost staff person and getting into this and figuring it all out and that somebody kind of told me, "Nothing's

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going to happen. They're going to have this meeting and then nothing's going to happen." And then it was like every two years they had a meeting and then nothing happened, so.

Shail Shah ([22:48](#)):

It's still, nothing is happening.

Nikki Dobay ([22:52](#)):

Nothing's happening. All right. Well, maybe something will happen. There's a new director at the CDTFA, so-

Shail Shah ([22:57](#)):

There is.

Nikki Dobay ([22:57](#)):

... maybe she'll get it, move it along. So Godspeed, that's what I'll say. All right, Shail. Well, thank you for the update. I'm really excited about this surprise non-tax question. I initially had a different question, which I'll ask you, but you don't have to answer it. Initially I was going to talk about Central Oregon, because I know you and your family like to come and visit, and I was going to ask you what your favorite thing to do here was. But then we were chatting before this pod, as you call it, and another one came to me. The question is, were you a DJ in college? And if so, what was your DJ name? I will answer first. I was a DJ in college. I was also a DJ after college on opbmusic, but I've never had a DJ name. I've always just been Nikki Dobay. So, that's been how I've rolled with this. But I'm going to ask you these questions now. Were you a DJ in college? And if so, what was your DJ name?

Shail Shah ([23:57](#)):

Leading questions here, but I was a DJ in college. I DJ-ed at UCLA's radio station. It was called Bruin Radio and Bruin Radio online. And I was a DJ for the Sunday evening hip hop show at UCLA. And I did have a DJ name, and it was DJ Shellshock. And one of the other DJs gave me that name, because he would constantly say my name really fast. He'd say, Shellshock, Shellshock, Shellshock. And he's like, "You know what? It kind of sounds like Shellshock." And he was like, "That's what we're going to call you." I was like, "All right, I'll go with it."

Nikki Dobay ([24:35](#)):

Okay, that's amazing. Can we call you Shareholder Shellshock?

Shail Shah ([24:42](#)):

Only on the pod, Nikki, only on the pod.

Nikki Dobay ([24:46](#)):

Outtakes. Okay, only on the pod. We've got Shareholder Shellshock back in the house talking about California. That's how you're going to be introduced from now on. And thank you again for joining and for catching us up on California. We'll do this again later this year. Thank you for the listeners for checking out the podcast. Information for Shail and I will be in the podcast, and I will be with you again on the next GeTtin' SALTy.

