

[Assembly Bill 160](#) (Dababneh)

Date: 04/09/15

Program: Sales and Use, Cigarette and Tobacco Products, and Diesel Fuel

Sponsor: BOE Chairman Jerome Horton

Penal Code Section 186.2

Revenue and Taxation Code Sections 6007 and 6009.2

Effective: January 1, 2016

Michele Pielsticker (Chief) 916.322.2376

Sheila T. Waters (Analyst) 916.445.6579

This analysis is limited to the bill's effect on the BOE-related tax programs

Summary: Among other things, adds tax fraud under the Sales and Use Tax, Cigarette and Tobacco Products Tax, and Diesel Fuel Tax laws, to the list of crimes eligible for civil forfeiture as "criminal profiteering activity," and removes the sale for resale exclusion for tangible personal property sold or purchased with counterfeit or illicit labeling, as defined.

Summary of Amendments: The amendments since the last analysis revise the definition of "organized crime" to, among other things, include crimes that through planning and coordination of individual efforts, seek to conduct the illegal activities of tax fraud, as specified.

Criminal profiteering: asset forfeiture: tax fraud

Penal Code Sections 186.2

Purpose: To stem tax evasion, which robs California of roughly \$8.5 billion every year—funds that are vital to public services, such as education, healthcare, and public safety. Tax fraud damages legitimate businesses and imposes unfair costs on law-abiding citizens. This bill seeks to stop tax evaders from profiting from their crimes, hold them financially liable, and capture tax revenues lost as a direct result of their criminal activities.

Fiscal Impact Summary: Asset forfeiture: revenue gain of several million dollars annually beginning in fiscal year 2016-17; counterfeiting offenses: potential gain of \$1.1 million annually.

Existing Law: Penal Code: asset forfeiture. Existing law¹ includes a mechanism for asset forfeiture applicable to, among others, those who engage in a criminal profiteering activity if that act may be charged as one of over 30 offenses, such as robbery, arson, murder, pimping, child pornography, forgery, etc. The law defines "criminal profiteering activity" as any act committed or attempted or any threat made for financial gain or advantage.

Existing law² provides that the purpose of asset forfeiture related to criminal profiteering activities is to "punish and deter" criminals.

For forfeiture to apply to criminal profiteering, existing law³ requires:

1. The defendant to be currently facing prosecution for one of approximately 30 specified offenses.
2. The prosecution to establish a "pattern of criminal profiteering activity," defined as:
 - a. At least two such criminal acts (including the charged crime) to be charged as a crime in the included list and committed, attempted, or threatened for financial gain;
 - b. The acts to not be isolated incidents, but rather have a similar pattern and purpose, result or victims;
 - c. The acts be activities of "organized crime;"

¹ Penal Code Sections 186-186.8.

² Penal Code Section 186.1.

³ Penal Code Section 186.2-186.3.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

- d. The prior act to have occurred within 10 years, excluding any period of imprisonment, of the underlying offense.

Existing law⁴ defines “organized crime” to mean, among other things, crime that is of a conspiratorial nature and that is either of an organized nature and seeks to supply illegal goods and services such as narcotics, prostitution, loan-sharking, gambling, and pornography, or that, through individuals’ planning and coordination of individual efforts, seeks to conduct the illegal activities of arson for profit, hijacking, insurance fraud, smuggling, operating vehicle theft rings, fraud against the beverage container recycling program, or systematically encumbering business assets to defraud creditors.

Existing law⁵ establishes the burden of proof in criminal profiteering asset forfeiture proceedings to be “beyond a reasonable doubt,” and requires a conviction of an underlying criminal offense. Criminal profiteering asset forfeiture is a criminal proceeding held in conjunction with the underlying criminal offense trial.⁶

Existing law⁷ specifies the following assets that are subject to forfeiture:

- A tangible or intangible personal property interest acquired through a pattern of criminal profiteering activity; and
- All proceeds of a pattern of criminal profiteering activity, including all things of value received in exchange for the proceeds derived from the pattern of criminal profiteering activity.

Existing law⁸ requires the prosecuting agency to notify every individual who may have a property interest in the forfeited property, and enables any interested party to file a verified claim with the superior court stating their claimed interest amount. The law⁹ specifies how the Department of General Services (DGS) or local governmental entity distributes the forfeited money or proceeds from the asset sales, as follows (the law provides other distribution requirements related to specific crimes against children, recycling beverage container fraud, and others):

- To the bona fide or innocent purchaser, conditional sales vendor, or holder of a valid lien, mortgage, or security interest, if any, up to his or her interest in the property or proceeds.
- To the DGS or local governmental entity for all expenditures made or incurred by it in connection with the property’s sale.
- To the state’s General Fund or a local government entity’s general fund, whichever prosecutes the case.

Restitution. Existing law¹⁰ grants persons who suffer losses due to criminal activity the right to seek and secure restitution from the persons convicted. The law requires courts to order restitution from a convicted offender in every case where a crime victim suffers a loss, unless it finds compelling and extraordinary reasons for not doing so.

For certain offenses, the law authorizes the Board of Equalization (BOE) to refer cases for criminal prosecution in state courts, and the court may order restitution. A restitution order covers the State’s economic loss from the crime. The State’s economic loss from criminal tax fraud includes the unpaid tax, interest, penalties, and investigation and prosecution costs attributable to the crime of which the taxpayer is guilty.

⁴ Penal Code Section 186.2(d).

⁵ Penal Code Section 186.5(d).

⁶ Penal Code Section 186.4(a).

⁷ Penal Code Section 183.3(b) and (c).

⁸ Penal Code Section 186.4(a).

⁹ Penal Code Section 186.8.

¹⁰ Penal Code Section 1202.4 and California Constitution, Article 1, Section 28.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.

Tax fraud is one of the most common offenses the BOE refers for criminal prosecution. Under existing law,¹¹ related criminal restitution orders are enforceable as if the order were a civil judgment, and the BOE may pursue collection as if it were a tax.

The BOE may also obtain federal court restitution orders for federal court-referred criminal charges. Mail fraud is one of most common charges the BOE pursues in federal court.

Revenue and Taxation Code. The BOE administers various business tax and fee programs including, among other things: sales and use tax,¹² cigarette and tobacco products tax,¹³ and diesel fuel tax.¹⁴

Tax Evasion. Existing law¹⁵ generally subjects persons guilty of tax evasion to fines or imprisonment, or both. Specifically, any person who violates the law with intent to defeat or evade the determination of an amount due is guilty of a felony when the tax liability aggregates \$25,000 or more in any consecutive 12- month period. The law requires each offense to be punished by a fine of \$5,000 to \$20,000, or imprisonment for 16 months, two years, or three years, or by both the fine and imprisonment in the court's discretion. For tax liabilities less than \$25,000, persons are guilty of a misdemeanor with associated punishment.

Seizure and sale. Existing law¹⁶ requires the BOE to seize any person's property, real or personal, when the person is delinquent in paying amounts due. The law requires the BOE to sell the property, or a sufficient part of it, at public auction to pay the amount due and any seizure and sale-related costs.

If the BOE determines that a delay will jeopardize tax collection, existing law¹⁷ enables the BOE to issue to a person a notice of jeopardy determination that requires the person to pay the amount immediately. The BOE may take action immediately to collect the determined liability. However, a person that receives a jeopardy determination notice may, within 10 days of the notice, file a petition and pursue remedies through the BOE's appeal process. The person must make a security deposit with the BOE for the amount the notice requires. Persons also may apply for an administrative hearing within 30 days of the notice to:

- Establish that the determination is excessive.
- Establish that the sale of property that may be seized should be delayed pending the administrative hearing because the sale would result in irreparable injury.
- Request a property release.
- Request stay of collection.

TRaCE. The Tax Recovery and Criminal Enforcement (TRaCE) Task Force is a pilot program enhanced by legislation enacted in 2013.¹⁸ TRaCE combats criminal tax evasion related to underground economic activity. This legislation authorizes team members and other participating agencies to exchange information to investigate, prosecute, and recover revenue lost in connection with illegal underground tax evasion. The task force is comprised of public officials from the BOE, Department of Justice, Franchise Tax Board, Department of Alcoholic Beverage Control, Employment Development Department, Federal Bureau of Investigation, and U.S. Immigration and Customs Enforcement's Homeland Security Investigations.

Proposed Law: This bill includes offenses related to piracy, insurance fraud, and tax fraud, as specified, within the definition of "criminal profiteering activity." In addition, this bill modifies the "organized crime" definition to add a requirement that the crime seek to supply illegal goods and services, or conduct illegal activities that involve fraud or deceit for monetary gain in any way.

¹¹ Penal Code Sections 1202.4, 1214, and 1214.2.

¹² Part 1 of Division 2 (commencing with Section 6001) of the Revenue and Taxation Code (RTC).

¹³ Part 13 of Division 2 (commencing with Section 30001) of the RTC.

¹⁴ Part 31 of Division 2 (commencing with Section 60001) of the RTC.

¹⁵ RTC sections 7153 (Sales and Use); 30480 (Cigarette); and 60707 (Diesel).

¹⁶ RTC sections 6796 (Sales and Use), 30355 (Cigarette), and 60461 (Diesel).

¹⁷ RTC sections 6536 (Sales and Use), 30241 (Cigarette), and 60330 (Diesel).

¹⁸ AB 576 (Stats. 2013, Ch. 614, effective January 1, 2014).

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Commentary:

1. **Effect of the bill.** In conjunction with an arrest, this bill enables state and/or local law enforcement entities to take control of an alleged tax evader's assets, including cash, when they have probable cause to believe the person was engaged in a criminal profiteering activity and obtained the cash or property from the profits of his or her illegal activity or the property was used when the person committed the illegal activity.
2. **Summary of amendments.** The April 9, 2015 amendments restore the "organized crime" definition in existing law and makes the following changes to that definition:

"Organized crime" means crime that is of a conspiratorial nature and that is either of an organized nature and seeks to supply illegal goods ~~and~~ or services such as narcotics, prostitution, pimping and pandering, loan-sharking, counterfeiting of a registered mark in violation of Section 350, the piracy of a recording or audiovisual work in violation of Section 653w, gambling, and pornography, or that, through planning and coordination of individual efforts, seeks to conduct the illegal activities of arson for profit, hijacking, insurance fraud, smuggling, operating vehicle theft rings, fraud against the beverage container recycling program, embezzlement, securities fraud, tax fraud and insurance fraud in violation of the provisions listed in paragraph 34 of subdivision (a), grand theft, money laundering, forgery, or systematically encumbering the assets of a business for the purpose of defrauding creditors. "Organized crime" also means crime committed by a criminal street gang, as defined in subdivision (f) of Section 186.22. "Organized crime" also means false or fraudulent activities, schemes, or artifices, as described in Section 14107 of the Welfare and Institutions Code, and the theft of personal identifying information, as defined in Section 530.5.

3. **The asset forfeiture provisions could be an effective tool to recover unpaid liabilities from convicted tax evaders.** While the BOE currently is authorized to seize and sell assets when the BOE believes collecting the amount may be jeopardized, this process generally occurs after the BOE audit or investigation is completed, the unreported amounts are identified, and the BOE issues the jeopardy determination. This delay contributes to the tax debtor's ability to conceal or dissipate assets and further jeopardizes the BOE's ability to collect amounts due. This bill enables a prosecuting agency, when it has probable cause to believe tax fraud has occurred, to freeze bank accounts and take control over forfeitable assets in conjunction with the arrest. Once the person is convicted of the crime, the DGS or local government entity would sell the forfeited assets and distribute the proceeds in a manner specified in law.

Sales and Use Tax: Counterfeiting Offenses

Revenue and Taxation Code Sections 6007 and 6009.2

Purpose: To bar sellers who are convicted of a counterfeit-related offense from enjoying a tax benefit that is otherwise available to legitimate businesses. The removal of the exclusion serves to minimize profits and prevent the counterfeit products from entering the retail stream and deceiving consumers.

Existing Law: California law imposes the sales tax on the "retail sale" or "sale at retail" (hereinafter referred to as "retail sale") of tangible personal property in this state. California law also imposes the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The sales or use tax is computed on the retailer's gross receipts or the sales price, respectively, unless the law provides a specific exemption or exclusion.

The law defines a "retail sale" as a sale for any purpose other than resale in the regular course of business. Generally, for illegal sales of goods in California, the law imposes a sales or use tax on the retail sales and purchases of those goods in the same manner as legitimate sales. However, beginning

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

September 19, 2014, the law¹⁹ specifies that a “convicted seller’s” or a “convicted purchaser’s” sales and purchases of tangible personal property with a counterfeit mark²⁰ on, or in connection with, that sale or purchase, is subject to sales or use tax, regardless of whether these sales are for resale in the regular course of business. Under these provisions, if a person is convicted of trafficking in counterfeit goods under certain Penal Code provisions,²¹ then all sales and purchases of those counterfeit goods on or before the conviction date are considered taxable. This applies whether the convicted seller or purchaser is a manufacturer, wholesaler, distributor, or a retailer of the counterfeit goods.

Under federal law, a “counterfeit mark” generally relates to a trademark used to confuse or deceive a consumer that is identical with, or substantially indistinguishable from, the genuine trademark.

Proposed Law: This bill specifies that a “convicted seller” and a “convicted purchaser” means a person convicted of a counterfeiting offense, including, but not limited to, specified counterfeiting-related violations.

Background: The BOE Members unanimously voted to sponsor the 2014 legislation related to convicted sellers’ and purchasers’ sales of counterfeit goods. That legislation targeted counterfeit good sales, as they unfairly compete with the original brand, tarnish the reputation of the original brand, cause a revenue loss, and potentially cause sickness or injury, such as counterfeit drugs or auto parts. The Legislature unanimously approved this measure.

Commentary:

- 1. Effect of the bill.** This measure subjects convicted sellers and convicted purchasers to liability for the sales or use tax on any non-retail sale or any purchase of goods associated with a counterfeiting offense, including, but not limited to, goods that criminally infringe on a copyright, or goods with a counterfeit or illicit label.
- 2. Inadvertent omission.** As the TRaCE team continues its work on tax evasion operations associated with the underground economy, it has identified other counterfeit-related goods trafficking violations that were inadvertently omitted in the 2014 legislation. For example a California retailer was recently arrested for selling counterfeit gold bullion bars and silver. Since the alleged violation relates to illegal labeling, rather than illegal use of a trademark, the current provisions that impose tax on a convicted seller’s purchase price or non-retail sales are not applicable if the seller is convicted (the sales tax on the retailer’s gross receipts from sales in this state to consumers, applies however, under the general Sales and Use Tax Law provisions). This bill makes it clear that a seller or purchaser convicted of any counterfeiting offense is liable for the tax on all his or her sales and purchases of goods, even when the sales are illegal.

Administrative Costs: The BOE will incur minor absorbable administrative costs.

Revenue Impact:

Asset forfeiture. For fiscal year (FY) 2011-12 through FY 2013-14, the BOE conducted 75 criminal tax fraud audits amounting to approximately \$58 million (\$29 million annual average) in unpaid cigarette and tobacco products tax and sales and use tax liabilities and related interest and penalties. The number of tax fraud cases is expected to increase as TRaCE continues its efforts to combat tax evasion.

¹⁹ As added by AB 2681 (Stats. 2014, Ch. 477, in effect September 19, 2014).

²⁰ As defined in Section 2320 of Title 18 of the United States Code.

²¹ Penal Code Sections 350 or 653w or Section 2320 of Title 18 of the United States Code.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE’s formal position.

While restitution ordered from these cases is \$33 million, the BOE has received payments of only \$4 million on the restitution amounts, or \$2 million annually.²² With this bill's expanded asset forfeiture authority, the BOE anticipates greater and more expeditious recovery of state and local revenue from available cash and assets seized under this bill's authority. The exact recovery amount is indeterminable, but staff anticipates a potential revenue gain of several million dollars annually, beginning FY 2016-17.

Counterfeiting offenses. For AB 2681 (Dababneh), the 2014 legislation that removed the sales and use tax exclusion for convicted sellers' and purchasers' counterfeit goods sales, [the BOE analysis](#) estimated that sales tax associated with California's share of the United States counterfeit goods seizures²³ amounts to \$2.1 million. This figure was based on 2012 statistics published by the U.S. Customs and Border Protection Service (CBP).

The CBP published [2013 statistics](#) that reveal a 7% increase in seizures from 2012, which would increase the 2014 legislation's revenue estimate. However, information about the specific federal crimes associated with these seizures is unavailable. Staff assumes the CBP seizure statistics include goods with trademark violations in addition to goods associated with criminal copyright infringement and counterfeit and illicit labels. For purposes of this estimate, staff assumes seizures related to copyright infringement and counterfeit and illicit labeling account for half of the total seizures. Therefore, this bill likely would result in an additional \$1.1 million gain ($\$2.1 \text{ million} \times 50\% \times 7\% = \1.1). However, persons from whom this property is seized may face significant fines and imprisonment. Accordingly, total tax collections are likely to be considerably less with respect to this provision.

²² Restitution ordered in a criminal case may vary depending on how the case was ultimately resolved. The BOE continues collection efforts of the entire liability even when the restitution ordered is less than the liability at issue. In other words, restitution orders do not extinguish the tax liability; however, amounts paid as restitution for unpaid liability reduce that liability.

²³ *Intellectual Property Rights: Fiscal Year 2012 Seizure Statistics*, U.S. Customs and Border Protection Office of International Trade.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.