



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	02/20/13	Bill No:	Assembly Bill 575
Tax Program:	Sales and Use	Author:	V. Perez
Sponsor:	BOE Chairman Horton	Code Sections:	RTC 6007 & 6009.2
Related Bill:		Effective Date:	01/01/14

BILL SUMMARY

This bill specifies that any sale, storage, or use of counterfeit goods and tangible pirated intellectual property in this state constitutes a “retail sale” or “sale at retail.”

ANALYSIS

CURRENT LAW

California’s criminal law¹ makes it a crime, punishable by fines and imprisonment, for any person to willfully manufacture, intentionally sell, or knowingly possess for sale any counterfeit of a mark registered with the Secretary of State or the Principal Register of the United States Patent and Trademark Office.

Federal criminal law² also makes it a crime, punishable by fines and imprisonment, for any person to willfully infringe a copyright, or to intentionally:

- Traffic in goods or services and knowingly use a counterfeit mark on or in connection with such goods or services,
- Traffic in labels, patches, stickers, wrappers, badges, emblems, medallions, charms, boxes, containers, cans, cases, hangtags, documentation, or packaging of any type or nature, knowing that a counterfeit mark has been applied thereto, the use of which is likely to cause confusion, to cause mistake, or to deceive,
- Traffic in goods or services knowing that such good or service is a counterfeit military good or service the use, malfunction, or failure of which is likely to cause serious bodily injury or death, the disclosure of classified information, impairment of combat operations, or other significant harm to a combat operation, a member of the Armed Forces, or to national security, or
- Traffic in a counterfeit drug.³

Federal law defines “counterfeit mark” to mean a spurious mark, the use of which is likely to cause confusion, to cause mistake, or to deceive. Among other things, a “counterfeit mark” also includes a spurious mark that is

- Used in connection with trafficking in any goods, services, labels, patches, stickers, wrappers, badges, emblems, medallions, charms, boxes, containers, cans, cases, hangtags, documentation, or packaging of any type or nature;

¹ Penal Code Section 350.

² Title 17 of the United States Code, Section 501 et seq., Title 18 of the United States Code, Section 2320.

³ Title 18 of the United States Code, Section 2320.

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- Identical with, or substantially indistinguishable from, a mark registered on the principal register in the United States Patent and Trademark Office (USPTO) and in use, whether or not the defendant knew such mark was so registered; and
- Applied to or used in connection with the goods or services for which the mark is registered with the USPTO, or is applied to or consists of a label, patch, sticker, wrapper, badge, emblem, medallion, charm, box, container, can, case, hangtag, documentation, or packaging of any type or nature that is designed, marketed, or otherwise intended to be used on or in connection with the goods or services for which the mark is registered in the USPTO.

California law⁴ 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 tax⁵ 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 law⁶ defines a “retail sale” as a sale for any purpose other than resale in the regular course of business. With respect to 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.

Under existing law, tangible personal property sold to persons who resell the property prior to any use of that property is not subject to sales or use tax. For example, a toy manufacturer’s sale of toys to a wholesaler who resells the toys before making a taxable use of the toys qualifies as an exempt sale for resale.

In addition, tax does not apply to tangible personal property sold to persons who purchase the property to incorporate into a manufactured item to be sold.⁷ For example, tax does not apply to a supplier’s sale of fabric, plastic, and buttons to a doll manufacturer who incorporates these items into the manufactured doll to be resold. Also, tax does not apply to tangible personal property sold to retailers or other sellers who resell the property before they make a taxable use of the property. For example, tax does not apply when a toy manufacturer sells its finished products (toys) to a retail toy store for subsequent resale. Tax applies, however, when the retail toy store sells the toy to the consumer. The law regards that sale as a “retail sale.” The retailer is liable for the tax on the gross receipts or sales price of the toy sold to the consumer.

PROPOSED LAW

This bill revises the definition of “retail sale,” “sale at retail,” “use,” and “storage,” to include any sale in this state of tangible personal property with (1) a counterfeit mark on, or in connection with, that sale, or (2) that is pirated intellectual property, regardless of whether these sales are for resale in the regular course of business.

⁴ Revenue and Taxation Code (RTC) 6007 of the Sales and Use Tax Law.

⁵ RTC 6201, et seq. of the Sales and Use Tax Law

⁶ RTC Section 6007 of the Sales and Use Tax Law

⁷ BOE Regulation 1525(b)

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COMMENTS

1. **Sponsor and purpose.** As sponsor of this bill, BOE Chairman Jerome E. Horton believes that California should impose a sales or use tax on *all* California sales and purchases of counterfeit goods and tangible pirated intellectual property. The sponsor believes counterfeit good sales unfairly compete with the original brand, tarnish the reputation of the original brand, and cause a revenue loss. Moreover, the sponsor indicates that some counterfeit products potentially cause sickness or injury, such as counterfeit drugs or auto parts. According to the sponsor, pirating intellectual property also causes economic harm. It steals income from creative professionals and their support staff, destroys jobs, increases the cost of consumer goods produced by legitimate reproducers, and deprives state and local governments of tax revenues.

Chairman Horton notes that the bill reaches to the source of the counterfeit products in California, whether it's at the manufacturing, wholesale, or distributor level. The additional tax serves to minimize profits, and helps prevent the illegal products from entering the retail stream.

2. **What these new definitions accomplish.** If enacted, the sales or use tax will apply to *any* sale and purchase of these items in this state, regardless of whether that sale is by the manufacturer, wholesaler, distributor, or retailer. With respect to these illegal sales, the proposed definitions do not allow for untaxed sales for resale under any circumstances. Also, these definitions do not allow manufacturers, wholesalers, distributors, or retailers to claim a credit for the tax paid on their purchases of these illegal products or illegal components of the products.
3. **Offenders may be unlikely to comply.** Federal and state laws impose significant fines and imprisonment on persons found guilty of these illegal acts. Yet, piracy and counterfeit goods trafficking continue to grow. It is questionable whether violators will voluntarily comply with this provision. However, the removal of the sale for resale exemption is appropriate, considering these sales are illegal and can do significant harm to the public.

COST ESTIMATE

The BOE's administrative costs are absorbable.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

According to a January 2012 [report](#) by the National Intellectual Property Rights Coordination Center, China leads the world as the primary source for seized counterfeit and pirated goods in the United States. Experts generally agree that almost no counterfeit pirated intellectual property is seized by the federal, state, or local authorities.⁸ We believe that counterfeit goods and pirated intellectual property manufacturers, wholesalers, and distributors are unlikely to voluntarily remit sales and use tax on these sales. However, to the extent authorities identify violators and seize products, the BOE can issue applicable sales or use tax determinations against these violators.

⁸ *A False Bargain: The Los Angeles County Economic Consequences of Counterfeit Products*, Los Angeles County Economic Development Corporation, February 2007.

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The U.S. Customs and Border Protection Service (CBP) publishes seizure statistics annually.⁹ CBP reports numbers of seizures and their domestic value. Domestic value is the merchandise cost when last purchased. The statistics are comprehensive, and include all types of commodities seized. Commodities most seized include electronics, shoes, pharmaceutical goods, CDs, clothes, and perfume (those typically purchased by household consumers). The statistics report seizures from all “shipping environments,” including cargo, express delivery, mail, and all other methods. In federal fiscal year (October through September) 2011, cargo accounted for more than half the domestic value of seizures.

The CBP reports domestic seizures for federal fiscal years 2002 through 2011. The data discloses no obvious trend over the past ten years. Domestic seizure values have ranged from a 2005 low of \$93 million to a 2008 high of \$273 million. In 2011, the latest fiscal year reported, seizure values amounted to \$178 million.

State data are not identified in the CBP report. Since most seized goods are of a kind ultimately purchased by consumers, we believe that California’s 12 percent share of U.S. population reasonably represents California’s counterfeit goods and pirated intellectual property seizures.

REVENUE SUMMARY

Based on the CBP data discussed previously, and assuming California’s 12 percent share of U.S. population, we estimate that annual state and local sales and use tax revenue associated with these seizures is \$1.8 million (\$178 million x 12% x 8.38%). However, persons from whom this property is seized may face significant fines and imprisonment. Accordingly, total tax collections are likely to be considerably less.

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⁹ *Intellectual Property Rights: Fiscal Year 2011 Seizure Statistics*, U.S. Customs and Border Protection Office of International Trade.

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