STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Introduced:	**02/16/05**	Bill No:	**SB 323**
Tax:	**Sales and Use**	Author:	**Migden**
Related Bills:	**SB 633 (Dutton)**		

BILL SUMMARY

This bill would specify that if a determination is made that a person knowingly collected sales tax reimbursement and failed to timely remit that tax to the Board, there shall be a rebuttable presumption that the unreported tax is due to fraud or an intent to evade the taxes. The bill would provide that, in such cases, a 25% penalty would be imposed as a jeopardy determination, as specified.

ANALYSIS

Current Law

Under California's Sales and Use Tax Law, sales tax is imposed on all retailers for the privilege of selling tangible personal property in this state. Under Section 1656.1 of the Civil Code, whether a retailer may add sales tax reimbursement to the sales price of the tangible personal property sold at retail to a purchaser depends solely upon the terms of the agreement of sale. The law presumes that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if:

(1) The agreement of sale expressly provides for such addition of sales tax reimbursement;

(2) Sales tax reimbursement is shown on the sales check or other proof of sale; or

(3) The retailer posts in his or her premises in a location visible to purchasers, or includes on a price tag or in an advertisement or other printed material directed to purchasers, a notice to the effect that reimbursement for sales tax will be added to the sales price of all items or certain items, whichever is applicable.

Under Section 6485 of the Sales and Use Tax Law, a penalty of 25% is imposed if a person, due to fraud or an intent to evade the tax, fails to file a sales and use tax return or fails to report the sales or use tax. The Sales and Use Tax Law does not identify specific acts that would be determined to be fraudulent, except for cases in which a purchaser registers a vehicle, vessel, or aircraft outside this state for the purpose of evading the tax.

Under the law, Section 6536 authorizes the Board to issue a determination that must be paid within 10 days of its issuance, if the Board believes that the collection of the tax or other amount will be jeopardized by delay. This is called a jeopardy determination (normal determinations must be paid within 30 days, unless a taxpayer protests the amount). When a jeopardy determination is issued by the Board, the taxpayer may, in lieu of making payment, file a petition for redetermination within 10 days of the date of the determination. However, unlike normal determinations issued by the Board, the taxpayer is required, in lieu of payment, to post security as the Board deems necessary. The taxpayer may also apply for an administrative hearing.

In General

The intent required as evidence of fraud is a specific intent, and direct evidence is seldom available to prove fraud. Fraud must be determined from the surrounding circumstances, including the conduct of the taxpayer. The existence of specific intent may be shown by circumstantial evidence, sufficient to show a reasonable certainty the accused is intending to evade the tax. Specific intent may be shown by various circumstances, as follows:

(1) a gross understatement of sales coupled with the fact the taxpayer is an experienced business person.
(2) a consistent pattern of understating large amounts of sales.
(3) repeated understatements in successive periods.
(4) maintaining a double set of books, making false invoices or documents, destruction of records, concealment of assets or sources of income, handling one's business affairs in such a way that avoids the usual recording of transactions.
(5) total reported business and nonbusiness income does not support the standard of living being maintained.
(6) information of fraudulent action is received from suppliers or expert witnesses.
(7) any conduct, the likely effect of which would be to mislead or to conceal.

Under the Board’s Regulation 1703, *Interest and Penalties*, fraud or intent to evade is required to be established by clear and convincing evidence.

Proposed Law

This bill would amend Sections 6485 and 6514 of the Sales and Use Tax Law to specify that when a retailer knowingly collects sales tax reimbursement, as defined, and fails to timely remit that tax to the Board, there shall be a rebuttable presumption that the retailer’s failure is due to fraud or an intent to evade the sales and use tax. If this determination is made, the bill would impose a penalty of 25% of the tax as a jeopardy determination, as specified.

The bill would become operative January 1, 2006.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. According to the author’s office, the purpose of the bill is to make the law explicit that if a retailer collects sales tax from customers and fails to timely remit the tax to the state, it will be presumed that the taxpayer intended to defraud the state. In such cases, the

state will impose a higher penalty and immediately pursue collection of the amounts the taxpayer collected from customers.

2. **Customers entrust retailers to remit the tax to the State.** Sales taxes are generally regarded as “fiduciary taxes” or "trust taxes,” meaning the tax reimbursement collected from customers is never really the retailers’ money in the first place. Customers pay sales tax, and trust and expect businesses to send it to the state on their behalf. When sales tax reimbursement is collected from a customer, the business is, in effect, acting as the agent for the state or local government, collecting the government's money from the customer and then paying it over to the government on a periodic basis. A failure of the business to do so should be recognized as fraudulent in the law.

3. **Bill would clearly establish when the fraud penalty is applicable.** If a retailer collects tax reimbursement and fails to remit the tax to the state, this bill would presume that the failure was intended to defraud the state and would automatically allow for the imposition of the fraud penalty along with the jeopardy determination.

   Current Board practice is to treat collecting unremitted sales tax as one of eight equally weighted “badges of fraud.” This bill would create a bright-line fraud test by singling out collecting unremitted sales tax as an automatic indicator of fraud.

4. **Related legislation.** SB 633 (Dutton) would, among other things, amend the Evidence Code to provide that in any proceeding to which the Board is a party, the burden of proof is with the Board in any assertion of penalties for intent to evade or fraud and requires a clear and convincing evidence standard for such assertions, as specified.

COST ESTIMATE

Enactment of this bill could increase the Board’s workload to the extent that an increase in issuing jeopardy determinations and administrative hearings would occur. However, the increase in workload would likely be offset by the increased revenues attributable to the 25 percent penalty.

REVENUE ESTIMATE

Enactment of this bill could increase compliance with the Sales and Use Tax Law, thereby increasing revenues. However, the magnitude of this increase is unknown.

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