STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Enrolled**	Bill No:	**SB 1449**
Tax:	**Sales and Use**	Author:	**Migden & Klehs**
Related Bills:	**AB 2441 (Klehs)**		

BILL SUMMARY

This bill would impose a 40 percent penalty upon a person who knowingly collected sales tax reimbursement, as defined, or use tax and failed to timely remit that tax to the Board, except 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, unless otherwise exempt. 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 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 at 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.

Civil Code Section 1656.1 also presumes that the gross receipts from the retail sale of tangible personal property includes sales tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) a notice stating that the price of the item or price of taxable items includes sales tax reimbursement.

Under Section 6203 of the Sales and Use Tax Law, an out-of-state retailer that is engaged in business in California is required to collect use tax on sales made to California consumers and remit that tax to the Board. Under the law, Section 6204 of the Sales and Use Tax Law specifies that the tax collected by the retailer constitutes a debt owed by the retailer to the State.

The Sales and Use Tax Law provides for a variety of penalties for a person's failure to comply with the law. However, the law does not provide for a specific penalty

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attributable to situations in which a taxpayer knowingly collects sales tax reimbursement or use tax and fails to timely remit the tax.

Under the law, there are penalties that are mandatory and imposed automatically, such as those imposed because payments are made late or returns are filed after the due date, and there are others that are discretionary and that may be assessed as a result of an audit. The main penalties that are imposed are summarized as follows:

Nature of Penalty	Rate	Section
Failure to file a return	10%	6511
Failure to timely remit the tax when due	10%	6591
Negligence or intentional disregard of the laws or regulations	10%	6484
Fraud or intent to evade the law or regulations	25%	6485
Knowingly not obtaining a valid permit in order to avoid the tax	50%	7155
Improper use of a resale certificate for personal gain or to evade the tax	*	6072; 6094.5
Registration of vehicle, vessel, or aircraft out-of-state to evade the tax	50%	6485.1; 6514.1
Failure to obtain evidence that operator of catering truck holds valid seller's permit	$500	6074
Failure of retail florist to obtain permit	$500 **	6077

* 10% of the tax due or $500 whichever is greater
**Plus any other applicable penalty

Proposed Law

This bill would add Section 6597 to the Sales and Use Tax Law to provide that any person who knowingly collects sales tax reimbursement, as defined, or use tax, and who fails to timely remit that sales tax reimbursement or use tax collected to the Board, shall be liable for a penalty of 40 percent of the amount not timely remitted.

The bill would reference Section 1656.1 of the Civil Code for purposes of defining sales tax reimbursement, and would further specify that sales tax reimbursement shall also include any sales tax that is advertised, held out, or stated to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer.

The bill would exclude from the proposed penalty any person whose liability for the unremitted tax averages $1,000 or less per month, or does not exceed 5 percent of the total amount of tax liability for which the tax was collected for the period in which the tax was due, whichever is greater.

The bill further provides relief from the proposed penalty if the Board finds that the person's failure to timely remit the tax was due to reasonable cause or circumstances beyond the person's control. The bill provides that "reasonable cause or circumstances beyond a person's control" includes, but is not limited to, any of the following that caused the person's failure to make a timely remittance:

- The occurrence of a death or serious illness of the person or the person's next of kin.

- The occurrence of an emergency, as defined
- A natural disaster or other catastrophe directly affecting the person's business operations.
- The Board failed to send returns or other information to the correct address of record.
- The person's failure to timely remit the tax occurred only once over a 3-year period, or once during the period in which the person was engaged in business, whichever period is shorter.
- The person voluntarily corrected errors in remitting the tax in prior periods and remitted payment of the liability prior to being contacted by the Board.

In addition, the bill would specify that the provisions shall apply to any determination made by the Board pursuant to Article 2 (commencing with Section 6481), Article 3 (commencing with Section 6511) and Article 4 (commencing with Section 6536) of Chapter 5, of the Sales and Use Tax Law.

The bill would become operative January 1, 2007.

Background

During the 2005 Legislative Session, a similar measure, SB 323 (Migden), was vetoed by the Governor. That measure would have imposed a 50 percent penalty for a person's failure to timely remit sales tax reimbursement. In his veto message, the Governor stated the following:

> "This bill creates a rigid and overly severe punishment for the failure to remit sales taxes which have been collected. I strongly support tough laws to punish and discourage scofflaws who knowingly evade taxes. However, this measure provides no flexibility for errors made by individuals with no intent to evade taxes or defraud the state. Moreover, the Board of Equalization does not contend that this bill would result in a specific level of increased compliance. For these reasons, I cannot support this bill."

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 enhance the penalty in cases where a retailer knowingly collects sales tax reimbursement or use tax from customers and fails to timely remit the tax to the state.
2. **Key amendments.** The **August 7, 2006 amendments** reduced the proposed penalty from 50 percent to 40 percent. The **June 26, 2006** amendments made nonsubstantive clarifying changes and added a coauthor. The **May 11, 2006 amendments** specified that the proposed penalty shall apply to determinations issued pursuant to specified provisions in the Sales and Use Tax Law. In the previous version of this bill, the proposed penalty would have only applied to determinations issued in cases where the Board is not satisfied with the amount of tax paid with a return or returns filed by taxpayers. These amendments specified that, in addition, the proposed penalty also applies to determinations issued in cases where a person failed to file a return, and in cases where the Board issues a jeopardy determination (these are determinations issued when the Board believes that the collection of the tax will be jeopardized by delay). **The May 2, 2006**

amendments specified that the phrase "sales tax reimbursement" shall also include any sales tax that is advertised, held out, or stated to the public or to any customer, directly or indirectly, that the tax or any part thereof will be assumed or absorbed by the retailer. Therefore, a retailer that knowingly fails to timely remit that tax could also be subjected to the proposed 50 percent penalty.

3. **Customers entrust retailers to remit the tax to the State.** Proponents note that sales tax reimbursement or use tax paid to a retailer is generally regarded by customers as "fiduciary taxes" or "trust taxes." The customers perceive the tax they pay to retailers as the State's money, not the retailers'. Customers who pay sales tax reimbursement or use tax to a retailer trust and expect the retailer to send it to the state; otherwise they would have no obligation to reimburse or pay the retailer. When sales tax reimbursement or use tax is collected from a customer, the customers' perception is that 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 subjected to enhanced penalties.
4. **Bill addresses Governor's veto message of last year's SB 323.** In his veto message, the Governor indicated that SB 323 provides no flexibility for errors made by individuals with no intent to evade taxes or defraud the state. Unlike SB 323, this measure provides several examples of reasonable circumstances that, if any one of them occurred - or any other reasonable circumstance - that caused the person's failure to timely remit the tax, the taxpayer would be relieved of the proposed penalty.
5. **Related legislation.** AB 2441 (Klehs) would have imposed a 50 percent penalty for a person's failure to timely remit sales tax reimbursement or use tax collected. That bill has been gutted and amended, and no longer falls under the Board's purview.

COST ESTIMATE

Enactment of this bill could increase the Board's workload attributable to some minor programming changes, an increase in billings for the new penalty, and processing requests for relief. However, the increase in workload would likely be offset by the increase in compliance and the increase in revenues attributable to the 40 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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