STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	
IRVINE PHOTO GRAPHICS, INC.	Account Number SR EA 99-574726 Case ID 557007
Petitioner	Irvine, Orange County

Type of Business: Printer

Liability period: 01/01/05 – 03/31/05

Item	Disputed Amount
Erroneous refund of excess tax reimbursement	$468,491
Fraud penalty	$117,123

Tax as determined and protested	$468,491.28
Interest through 07/31/13	390,845.97
Fraud penalty	117,122.82
Total tax, interest, and penalty	$976,460.07
Payments	- 1.76
Balance Due	$976,458.31
Monthly interest beginning 08/01/13	$ 2,342.45

This is an appeal that is covered by Revenue and Taxation Code section (Section) 40. Therefore, after the Board has made a determination in this matter, a written opinion that, among other things, sets forth the relevant factual findings and the legal analysis on which that determination is based must be published on the Board's website within 120 days from the date the Board renders a final decision in this matter. Accordingly, the Board may wish to consider the following two options:

(1) The Board could follow its usual practice in business tax appeals, in which it typically votes to resolve the appeal on the day of the hearing. Under the usual practice, a notice of the Board's determination will be mailed within 45 days of the date of the Board's vote, and the 30-day period for the filing of a Petition for Rehearing (PFR) would begin on the date the notice is mailed. If a PFR is not filed, the Board's determination will become final and its decision will be rendered at the expiration of the 30-day PFR period. Unless the Board specifically directs that it desires to issue a precedential (Memorandum Opinion) decision in this matter, staff would then expeditiously bring back a proposed (nonprecedential) Summary Decision that complies with Section 40 for the Board's approval on a later calendar. The adopted decision will be published timely on the Board's website. If a PFR is filed, no decision will be rendered until the conclusion of the petition for rehearing process.

(2) The Board could inform staff of its tentative determination and direct staff to prepare a proposed Summary Decision (or Memorandum Opinion) that reflects the tentative determination for Board approval as soon as practicable. Under this option, the Board would hold any determination of the appeal in abeyance until it has the opportunity to consider the proposed decision. The Board's later vote to adopt the decision would also constitute its vote to resolve the appeal, and within 45 days a notice of decision would be mailed. The 30-day PFR period would begin running when the notice of the Board's determination was mailed. If no PFR is filed, the Summary Decision (or Memorandum Opinion) would then be timely posted on the Board's website pursuant to Section 40.

We also note that petitioner could request during the oral hearing that the Board take Option 2 above and defer its vote to determine the appeal until it adopts a Summary Decision (or Memorandum Opinion). Such a request would, of course, defer resolution of the appeal and interest would continue to accrue. On the other hand, petitioner may prefer that the Board follow its usual practice in business tax appeals, which typically would result in a vote to resolve the appeal on the day of the hearing, thus accelerating the resolution process, but potentially requiring petitioner to file a PFR before it sees the content of the Summary Decision (or Memorandum Opinion) adopted by the Board.

This matter was scheduled for Board hearing in February 2013, but was postponed at petitioner's request because of pending litigation, which has not yet been resolved. It was rescheduled for hearing in April 2013 but was postponed at petitioner's request because it was seeking new representation.

UNRESOLVED ISSUES

Issue 1: Whether the refund was erroneous. We find that, since petitioner was required to remit the refund to its customer and has not done so, the refund was erroneous.

Petitioner sold printed marketing materials to Gap, Inc., and it charged and collected California sales tax reimbursement on all of its sales to Gap, even if the materials were shipped directly to locations outside of California via common carrier. In 2000, Gap hired KPMG LLP to identify and pursue refunds for any of Gap's overpayments of state sales tax. At the request of KPMG, petitioner filed two claims for refund of excess tax reimbursement collected in connection with its nontaxable sales to Gap. A refund measured by $5,531,248 was approved by the Board on January 25, 2005, on the condition that the excess tax reimbursement be refunded to Gap. Although representatives of Gap

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and KPMG contacted petitioner on numerous occasions, petitioner failed to remit the refund to Gap, and Gap contacted the Sales and Use Tax Department (Department) for assistance.

On September 3, 2010, the Department sent a letter to petitioner requesting that it provide evidence that it had refunded the excess tax reimbursement to Gap. Petitioner responded by letter dated October 11, 2010, that it had an agreement with Gap to deduct its costs incurred in supporting the claims for refund and that those costs exceeded the actual refund. On that basis, petitioner asserted that it was not required to issue any refund to Gap of the excess tax reimbursement. Since petitioner did not provide a copy of the alleged agreement with Gap and failed to provide evidence that it had refunded the excess tax reimbursement to Gap, the Department issued the Notice of Determination (NOD) for recovery of the erroneously issued refund.

Petitioner contends that it was entitled to retain the refund because of its alleged agreement with Gap. In that regard, petitioner has provided a copy of a letter to Gap that listed costs petitioner claimed it was entitled to deduct from the amount refunded by the Board and has asserted that it did not receive a reply from Gap until four years later, at which time Gap denied that the purported agreement existed. As additional evidence of the alleged agreement, petitioner has also presented copies of other correspondence, wherein cost reimbursement is mentioned, and statements by petitioner's bookkeeper that the corporate president told her of the agreement with Gap. In addition, petitioner asserts that its collection of sales tax reimbursement on nontaxable sales to Gap was not an error on petitioner's part, but was instead done at the specific request of Gap. Further, petitioner contends that the NOD is invalid because there was no excess tax reimbursement collected during the first quarter 2005, the period stated on the NOD.[1]

There is no dispute that petitioner collected excess tax reimbursement from Gap and that it received a refund of such reimbursement on the condition that it refund the same amount to Gap. However, the exhibits submitted by petitioner conclusively establish that it has not returned any of the

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[1] The latter two arguments are misplaced and will not be discussed in detail. First, the assertion that Gap directed petitioner to collect sales tax reimbursement on all sales is irrelevant since, whether it is accurate or not, the fact remains that petitioner collected excess tax reimbursement which it must refund to the customer or remit to the state. Also, the period of the determination is correct since it is the period during which the erroneous refund occurred, not the period during which the excess tax reimbursement occurred.

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refund to Gap. We find unpersuasive the evidence provided by petitioner to support its assertion that there was an agreement pursuant to which petitioner could retain costs, and that such costs exceeded the amount of the refund. Specifically, petitioner has not provided a copy of the agreement itself or correspondence from Gap expressing its agreement with petitioner's assertion that it should be reimbursed for the cost of pursuing the refund. In any event the question of whether a reimbursement agreement exists is irrelevant to the issue before us: whether the Board erroneously issued the refund. The law is clear that when a retailer collects excess tax reimbursement, it must either return such excess tax reimbursement to the customer or pay it to the state. Here, petitioner has done neither, and thus the Board is entitled to recover the refund.

It is our understanding that petitioner has tentatively agreed to refund the tax of $468,491.28 to Gap. If it did so, that payment would meet the requirement to refund the excess collection to the customer (Cal. Code of Regs., tit. 18, § 1700, subd. (b)(2)), and the NOD issued to petitioner would be canceled. However, petitioner has not yet refunded the excess tax collected to Gap.

Issue 2: Whether the Department has established fraud by clear and convincing evidence. We find that it has. [2]

The Department imposed a fraud penalty because it found that petitioner was aware of the requirement to return the excess tax reimbursement to Gap but failed to do so, and that petitioner in fact never intended to make the refund to Gap. The Department notes that there was extensive correspondence with petitioner's corporate president regarding the requirement to refund the excess tax collected to Gap. Petitioner responds that there was no fraud, reiterating its assertion that there was an agreement with Gap authorizing petitioner to offset the amount of refund for petitioner's costs related to recovering the refund. Petitioner also argues that the Department has not provided clear and convincing evidence of fraud. Specifically, petitioner claims that the Department has not shown that petitioner believed it had an obligation to make the refund to Gap or return the refund to the Board, since, according to petitioner, it believed it had fulfilled its obligation to Gap.

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[2] Absent a finding of fraud, the determination would not have been timely since it was issued more than three years after the last day of the month following the quarterly period in which the Board made its certification to the Controller that the amount collected was in excess of the amount legally due. (Rev. & Tax. Code, § 6961, subd. (b).)

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The Board expressly conditioned the payment of the refund to petitioner on petitioner's remittance of the excess tax collected to Gap. It is undisputed that petitioner knew of that requirement, since it has attempted to show that the requisite refund to Gap was offset by petitioner's costs related to acquiring the refund. Also, petitioner reported the Gap refund as a liability on its 2005 and 2006 corporate income tax returns. The declaration of the refund as an obligation on the 2005 and 2006 returns establishes that petitioner knew the refund was to be remitted to Gap. Petitioner's failure to make the refund to Gap despite such knowledge is strong evidence of fraud. Further, there is ample evidence of Gap's repeated efforts to recoup the excess tax reimbursement to which it is lawfully entitled, which is evidence contradictory to the agreement alleged by petitioner, which we have rejected, as explained under Issue 1.

We find that the Department has established fraud by clear and convincing evidence. As a result, the NOD was timely issued because there is no statute of limitations in the case of fraud. (Rev. & Tax. Code, § 6961, subd. (b).)

OTHER MATTERS

None.

Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

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