CALIFORNIA STATE BOARD OF EQUALIZATION

SUMMARY DECISION UNDER REVENUE AND TAXATION CODE SECTION 40

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	
	)	Account Number SR EA 99-574726
IRVINE PHOTO GRAPHICS, INC.	)	Case ID 557007
Petitioner	)	Oral hearing date: July 17, 2013

Representing the Parties:

For Petitioner: No Appearance

For Sales and Use Tax Department: Scott Claremon, Tax Counsel

For Appeals Division: Jeffrey G. Angeja, Tax Counsel IV

LEGAL ISSUE 1

Whether a refund of excess tax reimbursement paid to petitioner was erroneous.

FINDINGS OF FACT AND RELATED CONTENTIONS

Prior to the period at issue here, petitioner sold printed marketing materials to one of its customers (hereafter customer), and it reported tax and collected California sales tax reimbursement on all of its sales to the customer, even on exempt interstate commerce sales in which petitioner shipped the materials directly to locations outside of California via common carrier. Subsequently, the customer determined that the payments of tax and tax reimbursement on such sales constituted overpayments of sales tax. At the request of the customer, petitioner filed two claims for refund of excess tax reimbursement collected in connection with its nontaxable sales to the customer. A refund measured by $5,531,248 in nontaxable sales was approved by the Board on January 25, 2005, on the condition that the excess tax reimbursement petitioner collected on these sales, and paid to the Board, be refunded to the customer. Although the customer and its representatives contacted petitioner on numerous occasions demanding the return of the excess tax reimbursement it paid petitioner, petitioner

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failed to remit the refund of excess tax reimbursement to the customer, and the customer 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 the customer. Petitioner responded by letter dated October 11, 2010, stating that it had an agreement with the customer 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 the customer of the excess tax reimbursement. Since petitioner did not provide a copy of the alleged agreement with the customer (or any other evidence that the customer agreed to an offset of costs of any amount) and failed to provide evidence that it had refunded the excess tax reimbursement to the customer, the Department concluded that the refund was erroneous and thus issued a Notice of Determination for recovery of the erroneously issued refund, in the amount of $468,491.28 in tax, plus accrued interest, and a 25 percent fraud penalty of $117,122.82.

Petitioner contends that it was entitled to retain the refund because of its agreement with the customer. In that regard, petitioner has provided a copy of a letter to the customer 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 the customer until four years later, at which time the customer 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 petitioner's president told her of the agreement with the customer.

APPLICABLE LAW

Revenue and Taxation Code, section 6901.5 provides that when an amount represented by a taxpayer to a customer as constituting reimbursement for sales tax is computed upon an amount that is not taxable, or that is in excess of the taxable amount, and that is actually paid by the customer to the taxpayer, the amount so paid shall be returned to the customer or shall be remitted to this state. (Rev. & Tax. Code, § 6901.5; Cal. Code Regs., tit. 18, § 1700, subd. (b)(1).) A person who collected excess

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tax reimbursement will be afforded an opportunity to refund the excess collections to the customers from whom they were collected but, if the person fails or refuses to make such refunds, then the Board will make a determination against the person who collected the excess tax reimbursement, plus applicable interest and (if appropriate) penalties. (Cal. Code Regs., tit. 18, § 1700, subd. (b)(2).) If the person who collected the excess tax reimbursement wants to avoid incurring an obligation to the Board, the person must inform each customer in writing that the excess amount will be either refunded or credited to the customer's account, and submit proof of acknowledgement from each customer of the amount of the person's indebtedness to the customer. (Cal. Code Regs., tit. 18, § 1700, subd. (b)(3).)

Revenue and Taxation Code, section 6961, subdivision (b) provides that the Board may recover any refund or part thereof that is erroneously made and any credit or part thereof that is erroneously allowed.

ANALYSIS & DISPOSITION

There is no dispute that petitioner collected excess tax reimbursement from the customer and that petitioner received a refund of such reimbursement on the condition that petitioner refund the same amount to the customer. However, the exhibits submitted by petitioner conclusively establish that it has not returned any of the refund to the customer. We find petitioner's evidence unpersuasive to support its assertion that there was an agreement pursuant to which petitioner could retain any costs, and that such costs exceeded the amount of the refund. Specifically, petitioner has not provided a copy of the alleged agreement itself, nor correspondence *from the customer* expressing its agreement with petitioner's assertion that it should be reimbursed for the cost of pursuing 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.

LEGAL ISSUE 2

Whether the Department has established fraud or intent to evade tax by clear and convincing evidence.

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FINDINGS OF FACT AND RELATED CONTENTIONS

The Department imposed a 25-percent penalty of $117,122.82 for fraud or intent to evade tax because it found that petitioner was aware of the requirement to return the excess tax reimbursement refund to the customer but failed to do so. The Department based its conclusion on several items, including a series of correspondence between petitioner and the Department in which petitioner acknowledged the requirement to refund the excess tax reimbursement to the customer, and numerous written exchanges between petitioner and the customer in which the customer demanded the refund petitioner had received for the benefit of the customer. Petitioner does not dispute the existence of a clear record that establishes petitioner's receipt of the refund and its awareness that both the Department and the customer were demanding that the full refund amount be remitted to the customer.

Petitioner contends that it was not fraudulent in failing to refund the excess tax reimbursement to the customer and that it has presented persuasive proof of the existence of the reimbursement agreement, as discussed in the previous section.

APPLICABLE LAW

Revenue and Taxation Code section 6485 provides for the addition of a 25-percent penalty if any part of a deficiency determination is due to fraud or intent to evade the law or authorized rules or regulations. Fraud is intentional wrongdoing on the part of the taxpayer with the specific intent to avoid a tax known to be due. (*Bradford v. Commissioner* (9th Cir. 1986) 796 F.2d 303, 307 (*Bradford*); see also Sales and Use Tax Department Audit Manual (Audit Manual) § 0509.10.) Fraud must be established by clear and convincing evidence. (*Cal. State Bd. of Equalization v. Renovizor's Inc.* (9th Cir. 2002) 282 F.3d 1233, 1241; *Marchica v. State Bd. of Equalization* (1951) 107 Cal.App.2d 501, 508; Cal. Code Regs., tit. 18, § 1703, subd. (c)(3)(C).) Although fraud may not be presumed, it is rare to find direct evidence that fraud has occurred and thus it is often necessary to make the determination based on circumstantial evidence. (*Bradford, supra*, 796 F.2d at p. 307; *Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30; see Audit Manual § 0509.25.) Where there is a substantial deficiency that cannot be explained satisfactorily as being due to an honest mistake or to negligence and where the only reasonable explanation is a willful attempt to evade the payment of tax,

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the penalty for fraud or intent to evade the tax should apply. Certain facts or actions are by nature evidence of a deliberate attempt to evade the payment of tax, including the knowing failure to follow the requirements of the law. (See *Bradford, supra*, 796 F.2d at p. 307; see also Audit Manual §§ 0509.20, 0509.25.)

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ANALYSIS & DISPOSITION

Here, the Board issued a refund to petitioner on the express condition that petitioner remit that refund to the customer. It is undisputed that petitioner knew of the requirement to remit the excess tax reimbursement to the customer, and petitioner's own series of correspondence and other communication seeking to offset that refund with reimbursement for the expenses petitioner allegedly incurred in pursuing the refund clearly establish petitioner's actual knowledge that the excess tax reimbursement was required to be returned to the customer. Despite such knowledge, petitioner failed to do so, which is strong evidence of fraud. Above we have rejected petitioner's contention regarding the alleged reimbursement agreement. To the contrary, the evidence reflects the customer's multiple efforts to recoup the excess tax reimbursement to which it is lawfully entitled. Petitioner's failure to repay the excess tax reimbursement despite actual knowledge that it was required to do so and that the customer wanted its money back, is clear and convincing evidence of fraud. Accordingly, we conclude that the fraud penalty is appropriate.

ORDER

It is hereby ordered that the petition be denied and that the matter be redetermined without adjustment.

Adopted at Sacramento, California, on December , 2013.

_____, Chairman

_____, Member

_____, Member

_____, Member

_____, Member*

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*For John Chiang, pursuant to Government Code section 7.9.

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