

## 1 CALIFORNIA STATE BOARD OF EQUALIZATION

## 2 APPEALS DIVISION SUMMARY FOR BOARD HEARING

3 In the Matter of the Petitions for Redetermination )  
 4 Under the Sales and Use Tax Law of: )  
 5 SELECT OFFICE SOLUTIONS, INC. ) Account Number: SR Y AP 17-699390  
 6 ) Case ID's 187460, 345451  
 7 )  
 8 Petitioner ) Irwindale, Los Angeles County

9 Type of Business: Distributor of office equipment and supplies

10 Audit Period: 4/1/98 - 3/31/01 (187460)  
 11 1/1/02 - 6/30/05 (345451)

12	<u>Items</u>	<u>187460</u>	<u>345451</u>
13	Excess tax reimbursement on nontaxable buyout charges	\$5,808,943	\$2,665,354
14	Excess tax reimbursement on nontaxable installation charges	unknown <sup>1</sup>	\$712,844

15		<u>187460</u>	<u>345451</u>
16		<u>Tax</u>	<u>Penalty</u>
17	As determined	\$479,129.56	\$47,912.99
18	Adjustments: Appeals Division		-47,912.99
19	Proposed redetermination	\$479,129.56	\$0.00
20	Concurred in amount	-4,935.50	-15,277.40
21	Protested	<u>\$474,194.06</u>	<u>\$0.00</u>
22	Proposed tax redetermination	\$479,129.56	\$286,722.82
23	Interest	<u>409,444.14</u>	<u>168,998.77</u>
24	Total tax and interest	\$888,573.70	\$455,721.59
25	Payments	-49,756.46	-20,553.99
26	Balance due	<u>\$838,817.24</u>	<u>\$435,167.60</u>
27	Monthly interest beginning 10/1/09	<u>\$2,862.49</u>	<u>\$1,774.46</u>

## 22 UNRESOLVED ISSUES

23 **Issue 1:** Whether amounts itemized in internal invoices as buyout income but which were  
 24 included as tax in invoices to purchasers constitute excess tax reimbursement. We conclude they do.

25 \_\_\_\_\_  
 26 <sup>1</sup> In case ID 345451, petitioner did not report these amounts in its gross receipts, so the Sales and Use Tax Department had  
 27 to calculate the specific measure of deficiency to include in the determination. In case ID 187460 (the earlier audit),  
 28 however, petitioner included these amounts in its gross receipts, without taking a deduction (i.e., reporting tax on such  
 amounts, without having the measure specified) and then, in the audit, claimed it was entitled to an offsetting credit. Since  
 the Department concluded that the charges were taxable and an offset was not warranted, it did not calculate the measure.

1           During both audit periods, petitioner sold new copiers, fax machines, and other office  
2 equipment to leasing companies, and installed the equipment at the business locations of the leasing  
3 companies' customers. Petitioner initially negotiated the transactions with the end users of the  
4 equipment, but its actual purchasers were the leasing companies who leased the purchased equipment  
5 to the end users. These transactions commonly involved an end user with an existing lease of  
6 equipment which had become obsolete because of the rapid advance of technology. For some of these  
7 transactions, petitioner facilitated the rollover of the existing balance of the old lease into the lease of  
8 the new equipment petitioner was selling so that the end user did not have to make payments under the  
9 lease of the obsolete equipment as well as under the lease of the new equipment.

10           As a preliminary step in the process of arranging for the buyout of the old lease and selling the  
11 new equipment, petitioner prepared a hand written invoice for the end user, showing the sale price of  
12 the new equipment, and charges for delivery, setup, connect, lease buyout (the amount to pay off the  
13 prior lease), and buyout income (described by petitioner as its charge for facilitating the buyout and  
14 making buyout calculations). Subsequently, petitioner prepared a printed version of this invoice for its  
15 own internal use.<sup>2</sup> Petitioner's internal invoice itemized the selling price of the new equipment and  
16 amounts for delivery, setup, connect, buyout, and buyout income.<sup>3</sup> Below this itemized list was a  
17 subtotal of the selling price of the separately itemized pieces of equipment ("Sales Total") and a  
18 subtotal of the remaining itemized charges ("Misc Charges"). There was also a charge itemized as  
19 "Tax Total" which, based on the tax rate applicable for the invoice referred to by the SD&R/D&R, was  
20 measured by the subtotal for new equipment plus the itemized charge for delivery.<sup>4</sup>

21           Petitioner concedes that its internal invoice was not given to the leasing company that actually  
22 purchased the equipment for lease to the end user. Petitioner prepared a different invoice that it sent to  
23 the leasing companies who purchased the equipment from petitioner, and that invoice reflected a single

24 \_\_\_\_\_  
25 <sup>2</sup> A sample of such an invoice is attached as exhibit 1 to the SD&R/D&R; a copy of the corresponding invoice for the same  
transaction given to the purchasing leasing company is attached as exhibit 2 to the SD&R/D&R and is discussed below.

26 <sup>3</sup> It appears the buyout income was commonly calculated by applying the applicable tax rate to the combined charges  
27 itemized as buyout, setup, and connect. For example, in the invoice attached to the SD&R/D&R, the buyout income is 8.25  
percent of these charges, which is the same rate of tax calculated on the selling price of the new equipment plus delivery  
charge.

28 <sup>4</sup> This is consistent with the fact that, during the later audit period during which this invoice was generated, petitioner  
reported sales tax on these transactions measured by the sum of the itemized amounts for the equipment plus delivery.

1 lump-sum “Subtotal,” an amount itemized for “Tax,” and the total of these as “Balance Due.” The  
2 amount itemized as tax on these invoices to the purchasers was equal to the sum of the amount  
3 petitioner itemized in its internal invoice as buyout income plus the amount itemized as tax. The  
4 buyout income itemized in the internal invoice was equal to the tax that would have been due on the  
5 sum of the amounts itemized in the internal invoice for buyout, setup, and connect, if such amounts  
6 were all taxable. Since the buyout income was included in the charge itemized for tax in the invoice to  
7 the purchaser, the Department regarded petitioner as having collected tax reimbursement on the  
8 amount itemized in its internal invoice as buyout.

9         The Department issued determinations to petitioner based on its finding that the amount  
10 petitioner billed its purchasers is the selling price of the new product, which included the amounts  
11 itemized in its internal invoices as buyout. Accordingly, the Department assessed sales tax measured  
12 by those unreported buyout amounts of \$5,808,943 for audit period April 1, 1998, through March 31,  
13 2001 (case ID 187460), and \$2,665,354 for audit period January 1, 2002, through June 30, 2005 (case  
14 ID 345451).

15         Subsequently, the Department ascertained that petitioner did not receive payment from the  
16 purchaser of the buyout amount to pay off the prior lease, and thus concluded that such amount was  
17 not subject to tax. However, the Department asserts that an adjustment is not warranted because  
18 petitioner received excess tax reimbursement on the charges itemized as buyout. The Department  
19 asserts that the excess tax reimbursement petitioner collected must be paid to the Board if petitioner  
20 cannot, or will not, refund such amounts to its purchasers who paid the excess tax reimbursement.

21         Petitioner agrees that the amount itemized as buyout income in its internal invoice was included  
22 as tax in the invoice to the purchaser, but contends that this was done by mistake, and that its internal  
23 records clearly show that this was a fee for the services of arranging the rollover of the prior lease and  
24 providing the buyout calculations. The invoice provided to the end user, and the invoice used for  
25 internal purposes, clearly designate this amount as “buyout income” and not as “tax.” The  
26 SD&R/D&R describes petitioner as conceding that the amount itemized in the internal invoice as  
27 buyout income was similar to the amount of tax that would have been applicable if the amount  
28 itemized in the internal invoice as buyout were taxable, and that petitioner believes someone in the

1 company confused the two and mistakenly began clerically adding the buyout income as tax in the  
2 invoices to the purchasers. (Note, however, that, as explained above, the amount itemized as buyout  
3 income in the internal invoice referred to by the SD&R/D&R is *equal* to the tax that would have been  
4 due on the amounts itemized in the internal invoice as buyout, setup, and connect, if those amounts  
5 were taxable.) Petitioner contends that buyout income was properly included in the invoices because  
6 petitioner was entitled to the fee for arranging the buyout and for providing the purchasers with all of  
7 the information they needed to fund a new lease for the users, but that this amount was never  
8 considered tax or tax reimbursement. Petitioner also notes that internally, it allocated this amount to  
9 itself, and did not schedule it for payment as tax, nor did it remit it as tax, consistent with its position  
10 that it was a fee payable to petitioner for services.

11 California Code of Regulations, title 18, section 1700, subdivision (b)(1), provides that when  
12 an amount represented by a person to a purchaser as constituting reimbursement for sales tax is  
13 computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid  
14 by the purchaser to the person, the amount so paid is excess tax reimbursement. Excess tax  
15 reimbursement must be either refunded to the purchasers from whom they were collected, or paid to  
16 the state.

17 Here, petitioner represented to its purchasers that a specified amount was being billed as tax, a  
18 portion of which had been calculated on a measure that was not subject to tax. This is not an issue of  
19 what amounts petitioner was entitled to charge its purchasers *except* for amounts characterized as tax  
20 or tax reimbursement. Petitioner did collect an amount as tax on amounts that were not taxable, and  
21 that leads to the inescapable conclusion that petitioner collected excess tax reimbursement regardless  
22 of any alleged mistake or other possible intent. This is true whether petitioner mistakenly included the  
23 amount of buyout income in the tax total, or if, as it seems, actually calculated the amount itemized as  
24 buyout income as if it were tax on the amounts itemized in its internal invoice as buyout, setup, and  
25 connect: either way, the amount at issue was included as tax in the invoice to the purchaser. As such,  
26 we conclude such amounts constitute excess tax reimbursement that must be refunded to the  
27 purchasers who paid such amounts or paid to the state.

28



1 this case, we conclude that petitioner has been given ample opportunity to refund the excess tax  
2 reimbursement and that further delay is not warranted. Thus, we recommend that the petitions be  
3 denied. Our 2<sup>nd</sup> SD&R/SD&R explains petitioner's right to file a claim for refund if it does refund the  
4 excess tax reimbursement, such claim having to be filed within six months of the date each respective  
5 determination becomes final or within six months of the date petitioner pays each respective  
6 determination to the Board, whichever is later. (Rev. & Tax. Code, § 6902.)

7 **AMNESTY**

8 The 50-percent amnesty-interest penalty under Revenue and Taxation code section 7074,  
9 subdivision (a), is not applicable to either period in this case because petitioner filed an application for  
10 amnesty and entered into a qualifying installment-payment plan.

11 **RESOLVED ISSUE**

12 During the appeals conference, the Department recommended that the 10 percent for  
13 negligence be deleted. We agree. In this case, it appears the audit deficiency is primarily the result of  
14 petitioner's misunderstanding of the application of tax to complex transactions.

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17 Summary prepared by Rey Obligacion, Business Taxes Specialist III  
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