STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION FINAL ACTION SUMMARY

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

Type of Business: Distributor of office equipment and supplies

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

Items	Measure 187460	Measure 345451
Excess tax reimbursement on nontaxable buyout charges	$5,808,943	$2,665,354
Excess tax reimbursement on nontaxable installation charges	unknown[1]	$712,844

	187460 Tax	187460 Penalty	345451 Tax
As determined	$479,129.56	$47,912.99	$286,722.82
Adjustments: Appeals Division		-47,912.99	
Proposed redetermination	$479,129.56	$0.00	$286,722.82
Concurred in amount	-4,935.50		-15,277.40
Protested	$474,194.06	$0.00	$271,445.42
Proposed tax redetermination	$479,129.56		$286,722.82
Interest through 12/31/09	418,031.61		174,322.15
Total tax and interest	$897,161.17		$461,044.97
Payments	-49,756.46		-20,553.99
Balance due	$847,404.71		$440,490.98
Monthly interest beginning 1/1/10	$ 2,504.68		$ 1,552.65

The matter identified as case ID 187460 was scheduled for Board hearing on September 21, 2005, and was postponed upon request of the Legal Department, for further review. It was then scheduled for hearing March 8, 2006, and was postponed, upon petitioner's request, in order to

[1] In case ID 345451, petitioner did not report these amounts in its gross receipts, so the Sales and Use Tax Department had to calculate the specific measure of deficiency to include in the determination. In case ID 187460 (the earlier audit), 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.

combine that matter with the appeal of the audit that was in process at that time. Both matters were heard by the Board on September 23, 2009, with the Board Member from District 4 absent, and the remaining Members were unable to reach a decision. The matters were returned for decision on November 17, 2009, but were put over to the next Board meeting to provide Honorable Jerome Horton a further opportunity to review the appeal.

UNRESOLVED ISSUES

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

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

As a preliminary step in the process of arranging for the buyout of the old lease and selling the new equipment, petitioner prepared a hand written invoice for the end user, showing the sale price of the new equipment, and charges for delivery, setup, connect, lease buyout (the amount to pay off the prior lease), and buyout income (described by petitioner as its charge for facilitating the buyout and making buyout calculations). Subsequently, petitioner prepared a printed version of this invoice for its own internal use.[2] Petitioner's internal invoice itemized the selling price of the new equipment and amounts for delivery, setup, connect, buyout, and buyout income.[3] Below this itemized list was a

---

[2] 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.

[3] It appears the buyout income was commonly calculated by applying the applicable tax rate to the combined charges 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.

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

subtotal of the selling price of the separately itemized pieces of equipment ("Sales Total") and a subtotal of the remaining itemized charges ("Misc Charges"). There was also a charge itemized as "Tax Total" which, based on the tax rate applicable for the invoice referred to by the SD&R/D&R, was measured by the subtotal for new equipment plus the itemized charge for delivery.[4]

Petitioner concedes that its internal invoice was not given to the leasing company that actually purchased the equipment for lease to the end user. Petitioner prepared a different invoice that it sent to the leasing companies who purchased the equipment from petitioner, and that invoice reflected a single lump-sum "Subtotal," an amount itemized for "Tax," and the total of these as "Balance Due." The amount itemized as tax on these invoices to the purchasers was equal to the sum of the amount petitioner itemized in its internal invoice as buyout income plus the amount itemized as tax. The buyout income itemized in the internal invoice was equal to the tax that would have been due on the sum of the amounts itemized in the internal invoice for buyout, setup, and connect, if such amounts were all taxable. Since the buyout income was included in the charge itemized for tax in the invoice to the purchaser, the Department regarded petitioner as having collected tax reimbursement on the amount itemized in its internal invoice as buyout.

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

Subsequently, the Department ascertained that petitioner did not receive payment from the purchaser of the buyout amount to pay off the prior lease, and thus concluded that such amount was not subject to tax. However, the Department asserts that an adjustment is not warranted because petitioner received excess tax reimbursement on the charges itemized as buyout. The Department

[4] 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.

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

asserts that the excess tax reimbursement petitioner collected must be paid to the Board if petitioner cannot, or will not, refund such amounts to its purchasers who paid the excess tax reimbursement.

Petitioner agrees that the amount itemized as buyout income in its internal invoice was included as tax in the invoice to the purchaser, but contends that this was done by mistake, and that its internal records clearly show that this was a fee for the services of arranging the rollover of the prior lease and providing the buyout calculations. The invoice provided to the end user, and the invoice used for internal purposes, clearly designate this amount as "buyout income" and not as "tax." As explained in the SD&R/D&R, petitioner concedes that the amount itemized in the internal invoice as buyout income was similar to the amount of tax that would have been applicable if the amount itemized in the internal invoice as buyout were taxable. Petitioner believes someone in the company confused the two and mistakenly began clerically adding the buyout income as tax in the invoices to the purchasers. (Note, however, that, as explained above, the amount itemized as buyout income in the internal invoice referred to by the SD&R/D&R is *equal* to the tax that would have been due on the amounts itemized in the internal invoice as buyout, setup, and connect, if those amounts were taxable.) Petitioner contends that buyout income was properly included in the invoices because petitioner was entitled to the fee for arranging the buyout and for providing the purchasers with all of the information they needed to fund a new lease for the users, but that this amount was never considered tax or tax reimbursement. Petitioner also notes that internally, it allocated this amount to itself, and did not schedule it for payment as tax, nor did it remit it as tax, consistent with its position that it was a fee payable to petitioner for services.

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

Here, petitioner represented to its purchasers that a specified amount was being billed as tax, a portion of which had been calculated on a measure that was not subject to tax. This is not an issue of what amounts petitioner was entitled to charge its purchasers *except* for amounts characterized as tax

or tax reimbursement. Petitioner did collect an amount as tax on amounts that were not taxable, and that leads to the inescapable conclusion that petitioner collected excess tax reimbursement regardless of any alleged mistake or other possible intent. This is true whether petitioner mistakenly included the amount of buyout income in the tax total, or if, as it seems, actually calculated the amount itemized as buyout income as if it were tax on the amounts itemized in its internal invoice as buyout, setup, and connect: either way, the amount at issue was included as tax in the invoice to the purchaser. As such, we conclude such amounts constitute excess tax reimbursement that must be refunded to the purchasers who paid such amounts or paid to the state.

Issue 2: Whether petitioner collected excess tax reimbursement on the amounts itemized in its internal invoice as setup and connect. We conclude that it did.

During the earlier audit period, petitioner reported and paid sales tax on amounts itemized in its internal invoice as setup and connect, and asserted that it should not have done so and was entitled to an offset for the overpaid tax. Since the Department concluded that setup and connect charges were subject to tax, it concluded that the sales tax was correctly remitted and rejected the claimed offset. For the later audit period, petitioner did not report and pay sales tax on the amounts itemized in its internal invoice as setup and connect. Since the Department concluded that setup and connect charges were taxable, the Department assessed sales tax measured by $712,844 for the later audit period (case ID 345451).

Petitioner asserted that the amounts itemized in its internal invoices as setup and connect were charges for installation. We agreed, and concluded that such charges were not subject to tax. However, as explained above, when petitioner included the buyout income as tax in the invoice to the purchaser, it was billing the purchaser tax on the amounts itemized in its internal invoice as setup and connect. As such, it collected excess tax reimbursement which it must pay to the Board or refund to its purchasers who paid such amounts. Since petitioner has not refunded such amounts to its purchasers, we conclude that petitioner is not entitled to an offset against its audit liability for the amount of excess tax reimbursement it remitted to the Board as sales tax during the earlier audit period, and that no adjustment is warranted for the later audit period.

OTHER DEVELOPMENT

Petitioner filed a Request for Reconsideration indicating that it would refund the excess sales tax reimbursement to its purchasers, and also inquiring whether the leasing companies could *assign* their refunds to the lessees. The Department indicated that it would be acceptable for the leasing companies to assign their refunds to their lessees provided each assignment clearly identifies the lessor, the total refund due the lessor, the names of the lessees and amounts that they are entitled to receive, and that petitioner actually makes the refunds. We agreed. However, prior to responding to the request, we contacted petitioner's attorney for an update, and he indicated that petitioner still had not made the refunds but intended to borrow money in order to do so. Under the facts and history of this case, we conclude that petitioner has been given ample opportunity to refund the excess tax reimbursement and that further delay is not warranted. Thus, we recommend that the petitions be denied. Our 2nd SD&R/SD&R explains petitioner's right to file a claim for refund if it does refund the excess tax reimbursement, such claim having to be filed within six months of the date each respective determination becomes final or within six months of the date petitioner pays each respective determination to the Board, whichever is later. (Rev. & Tax. Code, § 6902.)

AMNESTY

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

RESOLVED ISSUE

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

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