State of California

Board of Equalization

Memorandum

To : Mr. Ramon J. Hirsig
Executive Director, MIC:73

Date: March 4, 2010

From : Kristine Cazadd, Chief Counsel
Legal Department, MIC:83

Subject : Board Meeting—March 25, 2010
Item J
Chief Counsel's Rulemaking Calendar
Regulation 1700, *Reimbursement for Sales Tax*

Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*, includes examples of how tax is calculated with discounts and trading stamps. The tax rate used in the examples is 6 percent. However, the tax rates in California now range from 8.25 to 10.75 percent and 8.25 percent will remain an active tax rate after the 1 percent temporary tax rate increase authorized by Revenue and Taxation Code sections 6051.7 and 6201.7 expires. As such, staff believes that the Board should update the examples using an 8.25 percent tax rate. Therefore, we request your approval to place proposed revisions to Regulation 1700 subdivision (b)(5) and (b)(5)(A) on the Chief Counsel's Rulemaking Calendar for March 25, 2010, for Board authorization to amend the examples under Rule 100, without the normal notice and public hearing process. These changesare appropriate for processing under Rule 100 because they are changes without regulatory effect and do not materially alter any requirement, right, responsibility, condition, prescription, or other regulatory element of any California Code of Regulations provision.

Attached is a strikeout and underline version of Regulation 1700 showing the updated examples.

If you have any questions regarding this request, please let me know or contact Mr. Bradley Heller at 324-2657.

Recommendation by:

Kristine Cazadd, Chief Counsel

Approved:

Ramon J. Hirsig, Executive Director

Approved:

BOARD APPROVED
At the _____ Board Meeting

Randie L. Henry, Deputy Director
Sales and Use Tax Department

Diane Olson, Chief
Board Proceedings Division

Attachments

cc (all with attachments):
Ms. Randie L. Henry (MIC 43)
Ms. Diane Olson (MIC 80)
Mr. Randy Ferris (MIC 82)
Mr. Bradley Heller (MIC 82)
Mr. Jeffrey L. McGuire (MIC 92)
Mr. Geoffrey E. Lyle (MIC 50)
Ms. Leila Hellmuth (MIC 50)
Ms. Lynn Whitaker (MIC 50)

Regulation 1700. REIMBURSEMENT FOR SALES TAX.

Reference: Section 6901.5, Revenue and Taxation Code; Section 1656.1, Civil Code.
Meals, tips and other charges as tax-included amounts, see Regulation 1603.

(a) REIMBURSEMENT FOR SALES TAX.

(1) ADDITION OF SALES TAX REIMBURSEMENT. 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.

(2) PRESUMPTIONS. Certain presumptions concerning the addition of sales tax reimbursement are created by Civil Code Section 1656.1. It shall be presumed that the parties agreed to the addition of sales tax reimbursement to the sales price of tangible personal property sold at retail to a purchaser if:

(A) The agreement of sale expressly provides for such addition of sales tax reimbursement;

(B) Sales tax reimbursement is shown on the sales check or other proof of sale; or

(C) The retailer posts in 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.

It shall be presumed that the property, the gross receipts from the sale of which is subject to the sales tax, is sold at a price which includes tax reimbursement if the retailer posts in his or her premises, or includes on a price tag or in an advertisement (whichever is applicable) one of the following notices:

1. "All prices of taxable items include sales tax reimbursement computed to the nearest mill."

2. "The price of this item includes sales tax reimbursement computed to the nearest mill."

(3) REIMBURSEMENT SCHEDULES. Each retailer who adds to the sales price of tangible personal property sold at retail an amount from a consumer in reimbursement of the sales tax upon gross receipts shall compute the amount of reimbursement by reference to schedules prepared by the board pursuant to Civil Code Section 1656.1 or by mathematical computation as described below. Schedules are available from the local district board offices for the various applicable rates. Reimbursement on sales prices in excess of those shown in the schedules provided by the board may be computed by applying the applicable tax rate to the sales price, rounded off to the nearest cent by eliminating any fraction less than one-half cent and increasing any fraction of one-half cent or over to the next higher cent.

(b) EXCESS TAX REIMBURSEMENT.

(1) DEFINITION. When an amount represented by a person to a customer 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 customer to the person, the amount so paid is excess tax reimbursement. Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when reimbursement is computed on an amount in excess of the amount subject to tax, when reimbursement is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the reimbursement on a billing.

(2) PROCEDURE UPON ASCERTAINMENT OF EXCESS TAX REIMBURSEMENT. Whenever the board ascertains that a person has collected excess tax reimbursement, the person will be afforded an opportunity to refund the excess collections to the customers from whom they were collected. In the event of failure or refusal of the person to make such refunds, the board will make a determination against the person for the amount of the excess tax reimbursement collected and not previously paid to the state, plus applicable interest and penalty.

(3) EVIDENCE SUFFICIENT TO ESTABLISH THAT EXCESS AMOUNTS HAVE BEEN OR WILL BE RETURNED TO CUSTOMER.

(A) If a person already has refunded to each customer amounts collected as reimbursement for tax in excess of the tax due, this may be evidenced by any type of record which can be verified by audit such as:

1. Receipts or cancelled checks.

2. Books of account showing that credit has been allowed the customer as an offset against an existing indebtedness owed by the customer to the person.

(B) If a person has not already made sales tax reimbursement refunds to each customer but desires to do so rather than incur an obligation to the state, the person must:

1. Inform in writing each customer from whom an excess amount was collected that the excess amount collected will be refunded to the customer or that, at the customer's option, the customer will be credited with such amount, and

2. The person must obtain and retain for verification by the board an acknowledgment from the customer that the customer has received notice of the amount of indebtedness of the person to the customer.

(4) OFFSETS. If a person who has collected excess tax reimbursement on a transaction fails or refuses to refund it to the customer from whom it was collected, the excess tax reimbursement shall be offset against any tax liability of the taxpayer on the same transaction. Any excess tax reimbursement remaining after the offset must be refunded to the customer or paid to the state. The offset can be made when returns are filed, when a determination is issued, or when a refund is claimed. Such offsets can be made only on a transaction by transaction basis. Tax reimbursement collected on a specific transaction can be used only to satisfy a tax liability arising from the same transaction. The "same transaction" means all activities involved in the acquisition and disposition of the same property. The "same transaction" may involve several persons, such as a vendor, a subcontractor, a prime contractor, and the final customer; or a vendor, a lessor, and a series of sublessors. Tax reimbursement can be offset against the tax liability of the taxpayer whether the liability was satisfied by paying sales tax reimbursement to a vendor, paying use tax to a vendor, or paying use tax to the state.

An offset of a taxpayer's own tax liability against tax reimbursement collected from a customer can be made only with respect to transactions in which possession of the property upon which the taxpayer's tax liability is based is transferred, either permanently or temporarily, to the customer, as in the case of construction contracts or leases. A taxpayer such as a repairman or printer who uses shop supplies or printing aids in performing a job for a customer cannot offset the tax liability arising from the use of the supplies or aids against tax reimbursement collected from the customer.

A person who claims that a tax liability on a transaction should be offset against tax reimbursement paid to the state by another person has the burden of proving that tax reimbursement was in fact paid to the state on the same transaction by the other person. In the absence of such proof no offset will be allowed. The offset allowances explained above are procedural changes mandated by statute and apply to all proceedings pending before the board on and after September 7, 1982.

(5) PARTICULAR APPLICATIONS. (Examples at ~~6~~ 8.25 percent tax rate.)

(A) DISCOUNTS AND TRADING STAMPS.

1. Discounts. A retailer who allows discounts on sales prices but charges customers tax reimbursement computed upon the prices before the discount is deducted is collecting excess reimbursement.

For example, a sale is made for $100 plus $~~6~~ 8.25 as tax reimbursement. Upon payment for the item the purchaser is allowed a discount of 20 percent of the sales price of $100 but the $~~6~~8.25 tax reimbursement is excluded from the computation. Since the retailer is deducting the amount of the discount, $20, from taxable gross receipts, the retailer is actually paying a tax of only $~~4.80~~6.60, i.e., ~~6~~8.25 percent of $80, and has retained excessive tax reimbursement of $~~1.20~~1.65.

2. Trading Stamps. A retailer who issues trading stamps or similar evidences of patronage may deduct as cash discounts the cost to the retailer of the stamps or other indicia (hereinafter called "stamps") issued in connection with taxable retail sales. A retailer who deducts the cost of stamps as a cash discount in computing the tax payable to the state, but who charges tax reimbursement on the full sales price of the goods, collects more tax reimbursement than the retailer pays to the state. The following illustration shows why this is true: If a retailer collects sales tax reimbursement of $~~6~~ 8.25 on a $100 sale but gives the customer trading stamps which cost the retailer $2 and then deducts the $2 as a cash discount when reporting taxable receipts, the retailer will pay a tax of only $~~5.88~~8.08 (~~6~~ 8.25 percent of $98).

The retailer must follow one of the three following procedures:

a. Adjust the price upon which tax reimbursement is computed so it will correspond to the price upon which the retailer computes the tax paid by the retailer to the state.

b. Consider the price which determines the number of stamps to be given a customer as the total amount paid by the customer, inclusive of that portion charged as reimbursement for sales tax.

c. Take no deduction from gross receipts in computing tax to be paid to the state on account of the cost of stamps given to customers.

(B) CONSTRUCTION CONTRACTORS. (See Regulation 1521 (18 CCR 1521) for application of tax to construction contractors generally.) A contractor furnishes and installs materials under a lump sum construction contract for the improvement of real property and collects tax reimbursement on the total contract price. As the contractor is the consumer of materials furnished and installed in the performance of the lumpsum contract, the tax reimbursement collected on the total contract price constitutes excess tax reimbursement. Such excess tax reimbursement must be returned to the customer or paid to the state. However, offsets will be allowed as explained in (b) (4).

Under a lump-sum contract to improve real property, a subcontractor furnishes and installs materials which were required without the payment of sales or use tax. The prime contractor collects tax reimbursement from the prime contractor's customer on the total contract price and pays all of the tax reimbursement collected to the state. The subcontractor's use tax liability on the materials consumed in performing the contract will be offset against the tax reimbursement paid to the state by the prime contractor, and the subcontractor has no further tax liability on the transaction. The tax reimbursement paid to the state by the prime contractor in excess of the use tax liability of the subcontractor will be refunded to the prime contractor only if it is returned to the customer.

(C) LESSORS OF MOBILE TRANSPORTATION EQUIPMENT. A lessor of mobile transportation equipment purchases such equipment under a resale certificate and collects tax reimbursement on the rental receipts, but pays no tax to the state. The lessor must pay tax on the purchase price of the equipment since a timely election to measure the tax by fair rental value was not made. The tax reimbursement collected on rental receipts is excess tax reimbursement. Such excess tax reimbursement must be returned to the lessee or paid to the state. However, offsets will be allowed as explained in (b) (4). (See Regulation 1661 (18 CCR1661) for application of tax to leases of mobile transportation equipment.)

(D) OTHER LESSORS OF TANGIBLE PERSONAL PROPERTY. A lessor purchases property and pays sales tax reimbursement to the vendor. The property is leased in the same form as acquired and tax reimbursement is collected on the rental receipts. Tax reimbursement collected on rental receipts must be returned to the lessee or paid to the state to the extent that it exceeds the tax liability measured by the purchase price. (See Regulation 1660 (18 CCR 1660) for application of tax to leases, generally.)

(6) RIGHTS OF CUSTOMERS. The provisions of this regulation with respect to offsets do not necessarily limit the rights of customers to pursue refunds from persons who collected tax reimbursement from them in excess of the amount due.