



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	08/05/14	Bill No:	<u>Assembly Bill 43</u>
Tax Program:	Sales and Use Tax	Author:	Bocanegra
Sponsor:	Author	Code Sections:	RTC 6901
Position:	None	Effective Date:	01/01/15

BILL SUMMARY

This bill authorizes a retailer to make an irrevocable election to assign the right to file a claim for refund and to receive the refund of excess tax reimbursement in the amount of \$50,000 or greater to a single customer so that the Board of Equalization (BOE) may make a direct refund to the customer.

Summary of Amendments

Since the previous analysis, the bill was amended to permit a retailer to assign the right to file a claim for refund of excess tax reimbursement in the amount of \$50,000 or greater to the customer, and not just the right to receive the refund payment only.

ANALYSIS

CURRENT LAW

Except where the law provides a specific exemption or exclusion, California Sales and Use Tax Law¹ imposes the sales tax on retailers for the privilege of selling tangible personal property at retail in this state. The retailer may collect reimbursement from its customer if the contract of sale so provides.² California law also imposes the use tax on the storage, use or other consumption in the state of tangible personal property purchased from any retailer.

Under existing Revenue and Taxation Code (RTC) Section 6901.5, when a retailer collects from a customer sales tax reimbursement where no tax is due or more sales tax reimbursement than is due, that excess tax reimbursement must either be returned to the customer or paid to the state.

RTC Section 6901 provides that, if the BOE determines that the retailer has paid any amount of sales tax more than once or has erroneously or illegally collected or computed the sales tax, the BOE must make note of it in its records, credit the amount to another of the retailer’s BOE liabilities, and refund the balance to the retailer, or to the retailer’s successor, administrator, or executor. To obtain a refund of sales tax, the retailer must submit a claim for refund to the BOE. Section 6901 further provides that the BOE shall refund any overpayment of use tax directly to the purchaser, even though the retailer collected and remitted the tax. In sum, while the statute allows the BOE to refund excess use tax directly to the purchaser, the BOE may issue a refund for excess sales tax reimbursement only to the retailer.

Under subdivision (b)(2) of the BOE’s Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*, which interprets Section 6901.5, whenever the BOE

¹ Part 1 of Division 2 (commencing with Section 6001) of the Revenue and Taxation Code (RTC).

² Civil Code Section 1656.1. California Code of Regulations, title 18, Regulation 1700.

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ascertains that a retailer has collected excess tax reimbursement, the retailer will be afforded an opportunity to refund the excess tax reimbursement to the customers from whom it was collected.

Regulation 1700(b)(3) provides that the BOE may refund to the retailer excess sales tax reimbursement upon submission of sufficient evidence that the excess tax reimbursement has been or will be returned to the customer. If a retailer has not refunded excess tax reimbursement to the customer, but would rather do so than incur an obligation to the state, the retailer must: (1) inform the customer in writing that excess tax reimbursement was collected and that the excess amount will be refunded or credited to the customer; and (2) obtain and retain for verification by the BOE an acknowledgement from the customer that the customer has received notice of the amount of indebtedness of the retailer to the customer. The BOE's form BOE-52-L2, *Notice of Pending Refund of Excess Sales Tax Reimbursement*, is available to assist the retailer in informing and obtaining an acknowledgment from the customer of the pending refund.

PROPOSED LAW

This bill, under limited circumstances, allows the BOE to refund excess sales tax reimbursement directly to the customer who was overcharged the sales tax reimbursement upon the retailer's irrevocable assignment of the right to file a claim for refund and to receive the refund. The BOE's direct refund to a customer would only be allowed for refunds of \$50,000 or greater to a single customer. The retailer and the customer both would need to sign the irrevocable assignment and submit it to the BOE with the retailer's or customer's claim for refund.

If enacted, the bill takes effect on January 1, 2015.

BACKGROUND

Last year's AB 1412, as amended May 24, 2013, contained provisions identical to this bill which the BOE Members had unanimously voted to sponsor. The bill passed the Assembly Appropriations Committee (17 ayes, 0 noes) and the Assembly (78-0).

On July 10, 2013, AB 1412 was amended to prohibit contingency fees that are charged or paid in connection with the election, assignment, or claim for refund relating to an irrevocable election to assign the right to receive a specified refund. The amendments were recommended by the Senate Governance and Finance Committee, which then passed the bill as amended (7 ayes, 0 noes). While the Senate Appropriations Committee passed the measure on consent, the bill stalled on the Senate Floor. On September 6, 2013, Assembly Members Bocanegra and Gatto gutted and amended the bill with provisions related to personal income taxation.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author to allow, under limited circumstances, a direct reimbursement to a customer who was overcharged sales tax reimbursement.
2. **The August 5, 2014, amendments** permit a retailer to assign the right to file a claim for refund of excess tax reimbursement in the amount of \$50,000 or greater to the customer, and not just the right to receive the refund payment only.
3. **Effect of August 5, 2014, amendments.** The January 6, 2014, version of the bill allowed a retailer to assign its right to receive certain refund payments to a

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customer. The August 5, 2014, version additionally permits a retailer to assign to a customer its right to file a claim for refund. This change results in substantial differences in implementation. The following explains those differences.

Implementation of assignment of the right to receive the refund payment only (January 6, 2014, version of the bill). Under this version of the bill, BOE's implementation would look as follows:

- BOE auditor staff would develop an assignment form, as part of BOE's Claim for Refund Form BT-101.
- Both the retailer and customer would sign this form.
- The retailer would file the Claim for Refund, which now includes the assignment form.
- BOE auditor would request the necessary documentation from the retailer (including sales invoices, sales journal, sales tax working papers, sales tax returns, and local tax schedules).
- BOE auditor will examine the retailer's records and process the refund to the single customer.

Thus, the only additional workload from the January 6, 2014, version of the bill relative to current law would come at the end of the refund process when the BOE has approved the refund and is ready to issue a warrant. At that time, the BOE would verify the customer's information on the assignment form, enter the customer information into the BOE's computer system, and then issue the warrant to the customer. All of the processing would be contained within the retailer's account.

As a hypothetical, consider a retailer of farm equipment that makes sales of equipment to 10 farmers. Subsequently, it is determined that the farm equipment qualifies for the partial state sales tax exemption for farm equipment and machinery. The retailer would complete one claim for refund with multiple assignment forms (ten in total, one for each farmer). A BOE auditor would (1) travel to the retailer's place of business, (2) confirm that the items were subject to the partial exemption and that the sales invoices verify that the tax was reported to BOE, and (3) approve the refund. BOE's Refund Section would make the appropriate entries in the BOE's computer system. The auditor would then enter the assignment information and generate a schedule to be sent to the State Controller's Office, which would, assuming each refund satisfied the cap, issue a warrant to each of the 10 farmers.

BOE's implementation of August 5, 2014, version (retailer assigns its right to file a claim for refund to the customer). Under this version of the bill, BOE's processes would be as follows:

- BOE audit staff would develop an assignment form, as part of BOE's Claim for Refund Form BT-101.
- The *retailer* would complete and sign the assignment form, but the *customer* would file the claim for refund (including the assignment form) with BOE.
- BOE auditor would request the necessary documentation from the customer to determine that it paid sales tax reimbursement. But in order to verify that the tax was paid to BOE, and that the items sold were non-taxable, staff would still have to contact the retailer to obtain the necessary documentation (sales journal pages, sales tax working papers, returns, and possibly sales invoice information). The auditor would also need to review the retailer's records to ensure that a

credit for the excess tax reimbursement was not provided by the retailer to the customer on a subsequent transaction. If there is a large volume of records to examine, it may require a BOE auditor to conduct the examination at the retailer's place of business. This could result in significant delays.

- A number of problems can arise when the customer files a claim for refund. First, the customer may not realize that a purchase transaction is outside the statute of limitations for issuing a refund (generally three years from the due date of the return for which the overpayment was made). In addition, in the case where a customer has more than one vendor, the auditor would have to issue a separate audit report or field investigation report for each retailer. This is necessary because BOE has to amend each retailer's return or returns. This causes two reports to be issued instead of one, which would be the case under the assignment of a refund payment only provisions. In addition, the customer may not have the documentation for BOE to validate and approve a refund. We will have to inspect the retailer's records to process the refund.
- In addition, audit staff would have to verify that neither the retailer nor the customer have an outstanding liability due to the BOE against which the excess amount should be credited prior to issuing a refund. Staff would be required to fully examine the books and records of the retailer, as if it filed the claim for refund itself, or risk issuing a refund while the retailer has outstanding liabilities. In other words, the new method will increase both the administrative burden and the risk of lost revenue.
- In addition, when a retailer assigns its right to file a claim for refund to its customer, the customer will then have appeal rights. However, the customer will have to file a separate appeal for each vendor/retailer. Whereas under the assignment for the refund payment only, if the BOE denies a retailer's claim for refund (which can include multiple customers), the retailer files one appeal encompassing the multiple transactions.
- BOE audit staff anticipates problems related to customers calculating purchases to reach the \$50,000 threshold. For example, if a large farmer makes five purchases of farm equipment paying \$10,000 in tax on each purchase over a two-year period, if one purchase is outside the statute of limitation, then the farmer will not meet the \$50,000 threshold.
- BOE audit staff expects more issues, as noted above, and therefore more processing in the case where a customer is allowed to file a claim for refund. Another complication is that some of the customers will not hold a permit with the BOE. While that can also be the case under the assignment of the refund payment only, there is a greater workload to process a refund versus cutting a check.
- As stated above, even though a customer would submit a claim directly to the BOE, it would still be required that the retailer make all the necessary records available for audit as needed, but they will not be in the possession of the customer. This could result in significant delays that would occur in scheduling the audit or investigation. (National retailers often are audited by many different states. This can tax an already lean staff. It often takes months to schedule audit appointments to coordinate with other audit requests of that retailer.) It is an additional layer of the process that may also require the audit of the retailer by a different auditor or even different district office. So even a simple scenario will

add additional work. If there are multiple vendors, then it will even further complicate the process and scheduling.

- This could lead to redundancies in BOE audit staff workload. Under the January 6, 2014, version, if there is a single retailer and multiple customers who are entitled to refunds of greater than \$50,000, an auditor would conduct a single examination of the retailer's records, and then could make payments directly to each customer. Under this version, staff would have to conduct an examination of each customer separately, even though each separate investigation would require an examination of the single retailer's records.
 - A retailer assigning its right to file a claim for refund to the customer creates the possibility of BOE issuing duplicate tax refunds. This creates the need to develop a database to track refunds.
4. **This bill authorizes a single retailer to assign the right to file a claim for refund for excess tax reimbursement to a single customer if that claim is at least \$50,000 in excess tax reimbursement.** The bill does not authorize a customer to file a claim for refund encompassing excess tax reimbursement which was collected and remitted by multiple retailers. The bill also does not authorize a customer to aggregate the excess tax reimbursement paid to multiple retailers to reach the \$50,000 threshold. An assignment may only be made by a retailer which, by itself, collected from the customer and remitted to the BOE \$50,000 or greater in excess tax reimbursement.

In addition, a single customer means a single person under the Sales and Use Tax Law. Under the Sales and Use Tax Law, a subsidiary is a separate entity/person from its parent. This means that if five subsidiaries of a single parent company each purchase directly from a retailer, the retailer may only make a separate assignment to each subsidiary that has, by itself, paid more than \$50,000 in excess tax reimbursement to the retailer. The parent company, or one of the subsidiaries individually, cannot file a single claim aggregating the claims of all the subsidiaries.

5. **Deallocation of local sales taxes and district taxes.** To process a refund claim, BOE would have to deallocate the Bradley-Burns local sales taxes and any applicable transactions (sales) and use taxes (also known as district taxes) reported and paid by the retailer. The BOE would have to determine which local jurisdiction was allocated the local sales tax and/or district tax revenue. This information may not be apparent from an invoice or sales receipt. In order to deallocate the tax, it may be necessary to examine the retailer's local tax schedules or other schedules and/or working papers used by the retailer to report and allocate its local and district taxes to the BOE. Without such verification, revenue may be deallocated from the wrong local jurisdiction.
6. **Refunds of excess tax reimbursement.** Under current law, when a customer overpays sales tax reimbursement to the retailer, the customer must obtain a refund of sales tax reimbursement directly from the retailer. Current law allows the BOE to issue a refund for excess tax reimbursement only to the retailer that collected and reported the sales tax.
7. **BOE's suggested amendments.** The bill as currently drafted authorizes a retailer to make an irrevocable election to assign the right to receive a refund payment of excess tax reimbursement in an amount of \$50,000 or greater to a single customer. The bill also allows the assignment form to be submitted in conjunction with the customer's claim for refund (the customer would now be able to file a claim for

refund). However, the bill is not clear that the retailer would make an irrevocable election to assign to the customer the right to file a claim for refund. BOE staff has drafted amendments that would accomplish the author's intent. (See page 7.)

COST ESTIMATE

The preliminary costs to implement this bill is estimated to be from \$500,000 to \$600,000. BOE staff would have to develop and maintain a database to allow tracking of refunds more carefully, avoiding duplicative tax refunds or other problems. Additional programming would still be required to BOE's main computer system to make modifications to various payment and return screens for the retailer's account to document the refund. The BOE's Technology Services Division estimates one-time programming costs of approximately \$200,000.

In addition, BOE estimates ongoing costs for four PY's at the Business Tax Specialist 1 classification. These four positions would be used to develop and maintain the new database, acknowledge refunds, determine if refund claims meet the specified criteria, verify and process refunds, handled refund claims which are partially or fully denied, and answer questions from retailers and customers.

REVENUE ESTIMATE

Indeterminable. To the extent that additional claims involving excess sales tax reimbursement would be filed, this could result in a state and local revenue loss.

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AB 43 – BOE Suggested Amendments

As amended 08/05/14

Section 6901 of the Revenue and Taxation Code is amended to read:

6901. (a) If the board determines that any amount, penalty, or interest has been paid more than once or has been erroneously or illegally collected or computed, the board shall set forth that fact in the records of the board and shall certify the amount collected in excess of the amount legally due and the person from whom it was collected or by whom paid. The excess amount collected or paid shall be credited by the board on any amounts then due and payable from the person from whom the excess amount was collected or by whom it was paid under this part, and the balance shall be refunded to the person, or his or her successors, administrators, executors, or customer as provided in subdivision (b), if a determination by the board is made in any of the following cases:

- (1) An amount of tax, interest, or penalty was not required to be paid.
- (2) Any amount of prepayment of sales tax, interest, or penalty paid pursuant to Article 1.5 (commencing with Section 6480) of Chapter 5 was not required to be paid.
- (3) Any amount that is approved as a settlement pursuant to Section 7093.5.

(b)(1) When an amount represented by a person to a customer as constituting reimbursement for taxes due under this part is computed upon an amount that is not legally due and is paid by the customer to the person and remitted by the person to the board, the ~~A~~ person that paid the tax may make an irrevocable election to assign to the customer the right to file a claim for refund as authorized pursuant to subdivision (a) and receive the amount refunded if all of the following conditions are met:

(A) The entire amount represents excess tax reimbursement that is required to be paid by the person to a single customer under section 6901.5.

(B) The amount to be refunded is fifty thousand dollars (\$50,000) or greater.

(C) The irrevocable election to assign to the customer the right to file a claim for refund and receive the amount refunded is evidenced by a statement signed by the person and the customer authorizing the named customer to file a claim for refund and receive the amount refunded.

(D) ~~The~~ Notwithstanding any other law, ~~The~~ signed statement is submitted to the board in conjunction with the ~~person's or customer's~~ claim for refund.

(2) The person that paid the tax and collected the excess tax reimbursement shall make the records to verify such refund available for inspection by the board, and no refund shall be payable until the board verifies by audit or other means the amounts are properly due for refund.

(3) The excess amount collected or paid shall be credited by the board on any amounts then due and payable from the person that paid the tax or amounts for which a notice of determination has been issued to the person that paid the tax, and amounts due and payable from the customer from which the excess tax reimbursement was collected. The balance shall be refunded to the customer that paid the excess tax reimbursement. An amount subject to refund that is credited to the person that paid the tax and not refunded to the customer that paid the excess tax reimbursement shall be paid by the person that paid the tax directly to the customer. In the event the person does not

make such payment, the credit that was on the amount due from the person will be reversed.

(c) Any overpayment of the use tax by a purchaser to a retailer who is required to collect the tax and who gives the purchaser a receipt therefor pursuant to Article 1 (commencing with Section 6201) of Chapter 3 shall be credited or refunded by the state to the purchaser.

(d) Any proposed determination by the board pursuant to this section with respect to an amount in excess of fifty thousand dollars (\$50,000) shall be available as a public record for at least 10 days prior to the effective date of that determination.