Assembly Bill 160 (Dababneh and Cooper)
Program: Sales and Use
Sponsor: BOE Chairman Jerome Horton
Penal Code Section 186.2
Revenue and Taxation Code Sections 6007 and 6009.2
Effective: January 1, 2016

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This analysis is limited to the bill's effect on the BOE-related tax programs

Summary: Removes the sale for resale exclusion for tangible personal property sold or purchased with counterfeit or illicit labeling, as defined and specified.

Purpose: To bar sellers who are convicted of a counterfeit-related offense from enjoying a tax benefit that is otherwise available to legitimate businesses. The removal of the exclusion serves to minimize profits and prevent the counterfeit products from entering the retail stream and deceiving consumers.

Fiscal Impact Summary: Potential $1.1 million state and local annual gain.

Existing Law: California law imposes the sales tax on the "retail sale" or "sale at retail" (hereinafter referred to as "retail sale") of tangible personal property in this state. California law also imposes the use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer. The sales or use tax is computed on the retailer's gross receipts or the sales price, respectively, unless the law provides a specific exemption or exclusion.

The law defines a "retail sale" as a sale for any purpose other than resale in the regular course of business. Generally, for illegal sales of goods in California, the law imposes a sales or use tax on the retail sales and purchases of those goods in the same manner as legitimate sales. However, beginning September 19, 2014, the law[1] specifies that a "convicted seller's" or a "convicted purchaser's" sales and purchases of tangible personal property with a counterfeit mark[2] on, or in connection with, that sale or purchase, is subject to sales or use tax, regardless of whether these sales are for resale in the regular course of business. Under these provisions, if a person is convicted of trafficking in counterfeit goods under certain Penal Code provisions,[3] then all sales and purchases of those counterfeit goods on or before the conviction date are considered taxable. This applies whether the convicted seller or purchaser is a manufacturer, wholesaler, distributor, or a retailer of the counterfeit goods.

Under federal law, a "counterfeit mark" generally relates to a trademark used to confuse or deceive a consumer that is identical with, or substantially indistinguishable from, the genuine trademark.

Proposed Law: This bill specifies that a "convicted seller" and a "convicted purchaser" means a person convicted of a counterfeiting offense, including, but not limited to, specified counterfeiting-related violations.

Background: The BOE Members unanimously voted to sponsor the 2014 legislation related to convicted sellers' and purchasers' sales of counterfeit goods. That legislation targeted counterfeit good sales, as they unfairly compete with the original brand, tarnish the reputation of the original brand, cause a revenue loss, and potentially cause sickness or injury, such as counterfeit drugs or auto parts. The Legislature unanimously approved this measure.

[1] As added by AB 2681 (Stats. 2014, Ch. 477, in effect September 19, 2014).
[2] As defined in Section 2320 of Title 18 of the United States Code.
[3] Penal Code Sections 350 or 653w or Section 2320 of Title 18 of the United States Code.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Commentary:

1. **Effect of the bill.** This measure subjects convicted sellers and convicted purchasers to liability for the sales or use tax on any non-retail sale or any purchase of goods associated with a counterfeiting offense, including, but not limited to, goods that criminally infringe on a copyright, or goods with a counterfeit or illicit label.

2. **Summary of amendments.** The **June 16, 2015** amendments made a nonsubtantive change by substituting "a" for "any" in Section 6007, and added a coauthor. The **May 5, 2015 amendments** removed the Penal Code provision that would have included tax fraud under the Sales and Use Tax, Cigarette and Tobacco Products, and Diesel Fuel tax laws to the list of crimes eligible for civil forfeiture as criminal profiteering activities. The **April 9, 2015 amendments** revised the definition of "organized crime" in the Penal Code provisions related to criminal profiteering activity to, among other things, include crimes that through planning and coordination of individual efforts, seek to conduct the illegal activities of tax fraud, as specified.

3. **Inadvertent omission.** As the TRaCE team continues its work on tax evasion operations associated with the underground economy, it has identified other counterfeit-related goods trafficking violations that were inadvertently omitted in the 2014 legislation. For example a California retailer was recently arrested for selling counterfeit gold bullion bars and silver. Since the alleged violation relates to illegal labeling, rather than illegal use of a trademark, the current provisions that impose tax on a convicted seller's purchase price or non-retail sales are not applicable if the seller is convicted (the sales tax on the retailer's gross receipts from sales in this state to consumers, applies however, under the general Sales and Use Tax Law provisions). This bill makes it clear that a seller or purchaser convicted of any counterfeiting offense is liable for the tax on all his or her sales and purchases of goods, even when the sales are illegal.

Administrative Costs: The BOE will incur minor absorbable administrative costs.

Revenue Impact: For AB 2681 (Dababneh), the 2014 legislation that removed the sales and use tax exclusion for convicted sellers' and purchasers' counterfeit goods sales, the BOE analysis estimated that sales tax associated with California's share of the United States counterfeit goods seizures[4] amounts to $2.1 million. This figure was based on 2012 statistics published by the U.S. Customs and Border Protection Service (CBP).

The CBP published 2013 statistics that reveal a 7% increase in seizures from 2012, which would increase the 2014 legislation's revenue estimate. However, information about the specific federal crimes associated with these seizures is unavailable. Staff assumes the CBP seizure statistics include goods with trademark violations in addition to goods associated with criminal copyright infringement and counterfeit and illicit labels. For purposes of this estimate, staff assumes seizures related to copyright infringement and counterfeit and illicit labeling account for half of the total seizures. Therefore, this bill likely would result in a potential additional $1.1 million gain ($2.1 million x 50% x 7% = $1.1).

[4] *Intellectual Property Rights: Fiscal Year 2012 Seizure Statistics*, U.S. Customs and Border Protection Office of International Trade.

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