Senate Bill 640 (Beall)
Date: 04/21/15
Program: Sales and Use Tax
Sponsor: RYAN Tax Services
Code: Revenue and Taxation Code Section 6901
Effective: January 1, 2016
**Revised Cost Estimate**

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**Summary:** Authorizes a retailer to make an irrevocable election to assign the right to file a claim for 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 with BOE suggested technical amendments.

**Purpose:** To allow, under limited circumstances, direct reimbursement to a customer who was overcharged sales tax reimbursement. According to the author's office, "Vendor assignment would shorten the refund process by approximately two to three months and eliminate processing by the retailer as the middleman. This bill will enable customers to receive refunds in a more expeditious fashion and ease the workload of certain retailers who will no longer be required to issue refund checks themselves, nor file a claim for refund on the customer's behalf."

**Fiscal Impact Summary:** Indeterminable. To the extent that additional claims would be filed, this could result in a state and local revenue loss.

**Existing Law:** Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law[1] imposes the sales tax on all 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 more sales tax reimbursement than is due from a customer, 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 note the amount in its records, credit the amount to the retailer's other BOE liabilities, and refund the balance to the retailer, or to the retailer's successor, administrator, or executor. To obtain a sales tax refund, 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 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.

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[1] Part 1, Division 2 of the Revenue and Taxation Code (RTC) (commencing with Section 6001).
[2] Civil Code Section 1656.1. California Code of Regulations, title 18, Regulation 1700.

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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:** Under limited circumstances, this bill allows the BOE to refund excess sales tax reimbursement 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 more to a single customer. The retailer and the customer would both need to sign the irrevocable assignment and submit it to the BOE with the customer's claim for refund.

The bill requires the retailer to retain records to verify the refund available for inspection by the BOE. The bill specifies that no refund will be payable until the BOE verifies by audit or other means that the amounts are properly due for refund.

The bill requires the BOE to credit the refund of excess tax reimbursement against amounts due and payable from the retailer for which an audit determination has been issued and against amounts owed by the customer. The balance will then be refunded to the customer who paid the excess tax reimbursement. The bill requires the retailer to refund the amount of excess tax reimbursement equal to any credit applied to the retailer's liability directly to the customer who paid it. If the retailer does not make the payment to the customer, the credit will be reversed.

The bill defines the following terms:

- "Person that paid the tax" means a single "person" as defined in Section 6005.
- "Customer" means a single "person" as defined by Section 6005.

If enacted, the bill takes effect on January 1, 2016.

**Legislative History:** In 2013, AB 1412 (as amended May 24, 2013) would have authorized a retailer to make an irrevocable election to assign the right to receive a refund payment of excess tax reimbursement in the amount of $50,000 or more to a single customer. 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.

In 2014, AB 43 (Bocanegra), which was identical to AB 1412, as amended May 24, 2013, passed out of the Assembly and the Senate Governance and Finance Committee (7 ayes, 0 noes). As amended August 5, 2014, AB 43 permitted a retailer to assign the right to file a claim for excess tax reimbursement in the amount of $50,000 or more to the customer, and not simply the right to receive refund payment. These amendments increased BOE's administrative costs considerably and the bill was held in the Senate Appropriations Committee.

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## Commentary:

1. **The April 21, 2015 amendments** are BOE suggested technical amendments to clarify that a "customer" means a single "person" as defined by Section 6005.

2. **Effect of the bill.** To implement this bill, the 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 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 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. Large volumes of records may require a BOE auditor to conduct the examination at the retailer's place of business. This could result in delays to obtain documentation and/or schedule an appointment to visit the retailer's place of business.
   - Audit staff would verify that neither the retailer nor the customer have an outstanding liability to the BOE against which to credit the excess amount prior to issuing a refund. Staff would examine the books and records of the retailer, to avoid issuing a refund while the retailer has outstanding liabilities.

3. **Potential issues to address.** A number of issues can arise when the customer, instead of the retailer, 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 the case where a customer has been assigned the right to claim a refund of $50,000 or more from more than one vendor, the auditor would issue a separate audit report or field investigation report for each retailer. Separate reporting is necessary because BOE must amend each retailer's return or returns.
   - In addition, when a retailer assigns its right to file a claim for refund to its customer, the customer will have appeal rights. The customer must file a separate appeal for each vendor/retailer from which it receives an assignment. Under current law, 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 issues related to the calculation of 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 limitations, then the farmer will not meet the $50,000 threshold.
   - Some customers may not hold a permit with the BOE.

     Even though a customer submits a claim directly to the BOE, the retailer still must make all the necessary records available for audit as needed, but they will not be in the customer's possession. If the customer does not have the documentation for BOE to validate and approve a refund, the BOE must inspect the retailer's records. This could result in significant delays to schedule the audit or investigation. (National retailers often are audited by many different states. This can burden an already lean staff. Scheduling audit appointments may take months to coordinate with other audit requests of that retailer.) If a customer receives an assignment from multiple vendors and makes refund claims for each, further complications may occur.

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- The process could lead to redundancies in BOE audit staff workload. Under current law, if a single retailer is entitled to a refund which relates to multiple customers that paid $50,000 or greater in tax reimbursement, an auditor conducts a single examination of the retailer's records, and then makes one payment to the retailer. Under this bill, staff would conduct a separate examination of each customer, as well as 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 duplicate tax refunds. A database to track refunds would be required.

4. **A single retailer can assign rights to a single customer.** 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. To do so would require separate refund claims meeting the threshold. The bill 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 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 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. Deallocating the tax may require examination of 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 verification, revenue may be misallocated.

**Administrative Costs:** To implement the bill, BOE staff would develop and maintain a database to allow more careful tracking of refunds, and to avoid duplicative tax refunds and other issues. Additional workload is required to acknowledge refunds, determine refund eligibility, verify and process refunds, handle refund claims which are partially or fully denied, prepare guidelines for staff, and answer questions from retailers and customers. Assuming the number of refund claims do not increase with the addition of the assignment option, staff is not anticipating additional personnel costs. Staff believes that it is premature to determine the number of PYs needed because the additional number of refunds with assignments is unknown at this time. However, staff requests that a safeguard provision be added to the bill to allow submission of a budget change proposal in the future if it determines that additional positions are needed (see page 5 for proposed amendment). BOE would utilize the normal budget process to do so.

In addition, programming to BOE's main computer system would be required to modify various screens for both the retailer and customer accounts to document the refund and assignment. These one-time programming costs are expected to be minor (under $50,000).

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

This revenue estimate does not account for any changes in economic activity that may or may not result from enactment of the proposed law.

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STATE BOARD OF EQUALIZATION

PROPOSED AMENDMENTS TO SB 640

AMENDMENT 1

On page 4, line 8, add:

SECTION 2. It is the intent of the Legislature to appropriate from the General Fund and Reimbursements an amount not less than the amount necessary to reimburse the State Board of Equalization for its administrative costs to implement and administer the changes made to the Sales and Use Law by amending Revenue and Taxation Code Section 6901, if the State Board of Equalization's estimate of the number of claims for refund filed pursuant to subdivision (b) thereof exceeds fifty (50) in any fiscal year and it is determined that the State Board of Equalization requires additional resources to administer the statute. The State Board of Equalization shall submit a budget change proposal using the normal budget process.