STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**04/19/05**	Bill No:	**SB 323**
Tax:	**Sales and Use**	Author:	**Migden**
Related Bills:	**SB 633 (Dutton)**		

BILL SUMMARY

This bill would specify that if a determination is made that a person knowingly collected sales tax reimbursement and failed to timely remit that tax to the Board, there shall be a rebuttable presumption affecting the burden of producing evidence that the unreported tax is due to fraud or an intent to evade the taxes. The bill would provide that, in such cases, a 25% penalty would be imposed as a jeopardy determination, as specified.

Summary of Amendments

The April 19, 2005 amendments would clarify that the rebuttable presumption applies to the burden of producing evidence.

ANALYSIS

Current Law

Under California's Sales and Use Tax Law, sales tax is imposed on all retailers for the privilege of selling tangible personal property in this state. Under Section 1656.1 of the Civil Code, 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. The law presumes 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:

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

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

(3) 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.

Under Section 6485 of the Sales and Use Tax Law, a penalty of 25% is imposed if a person, due to fraud or an intent to evade the tax, fails to file a sales and use tax return or fails to report the sales or use tax. The Sales and Use Tax Law does not identify specific acts that would be determined to be fraudulent, except for cases in which a purchaser registers a vehicle, vessel, or aircraft outside this state for the purpose of evading the tax.

Under the law, Section 6536 authorizes the Board to issue a determination that must be paid within 10 days of its issuance, if the Board believes that the collection of the tax or other amount will be jeopardized by delay. This is called a jeopardy determination (normal determinations must be paid within 30 days, unless a taxpayer protests the amount). When a jeopardy determination is issued by the Board, the taxpayer may, in lieu of making payment, file a petition for redetermination within 10 days of the date of the determination. However, unlike normal determinations issued by the Board, the taxpayer is required, in lieu of payment, to post security as the Board deems necessary. The taxpayer may also apply for an administrative hearing.

In General

The intent required as evidence of fraud is a specific intent, and direct evidence is seldom available to prove fraud. Fraud must be determined from the surrounding circumstances, including the conduct of the taxpayer. The existence of specific intent may be shown by circumstantial evidence, sufficient to show a reasonable certainty the accused is intending to evade the tax. Specific intent may be shown by various circumstances, as follows:

(1) a gross understatement of sales coupled with the fact the taxpayer is an experienced business person.
(2) a consistent pattern of understating large amounts of sales.
(3) repeated understatements in successive periods.
(4) maintaining a double set of books, making false invoices or documents, destruction of records, concealment of assets or sources of income, handling one's business affairs in such a way that avoids the usual recording of transactions.
(5) total reported business and nonbusiness income does not support the standard of living being maintained.
(6) information of fraudulent action is received from suppliers or expert witnesses.
(7) any conduct, the likely effect of which would be to mislead or to conceal.

Under the Board's Regulation 1703, *Interest and Penalties*, fraud or intent to evade is required to be established by clear and convincing evidence. Under administrative guidelines, there are certain acts that are of such nature that they are evidence that a deliberate attempt has been made to evade payment of tax, and that an evasion penalty is warranted. These acts, or "badges of fraud," are:

1. A substantial deficiency, which cannot be explained as due to negligence or honest mistake.
2. More than one set of records.
3. Falsified records.
4. Substantial discrepancies between recorded and reported amounts that cannot be explained.
5. Failure to follow requirements of law by a knowledgeable taxpayer, as evidenced by permits or licenses held by the taxpayer in prior periods, or disregard of specific advice as to the applicability of tax to certain transactions.

6. Tax properly charged to customers, evidencing a knowledge of the requirements of the law, but not reported.
7. Transfers of amounts of unpaid tax from the tax accrual account to another income account.
8. Consistent substantial underreporting.

Proposed Law

This bill would amend Sections 6485 and 6514 of the Sales and Use Tax Law to specify that when a retailer knowingly collects sales tax reimbursement, as defined, and fails to timely remit that tax to the Board, there shall be a rebuttable presumption affecting the burden of producing evidence that the retailer's failure is due to fraud or an intent to evade the sales and use tax. If this determination is made, the bill would impose a penalty of 25% of the tax as a jeopardy determination, as specified.

The bill would become operative January 1, 2006.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the author. According to the author's office, the purpose of the bill is to make the law explicit that if a retailer collects sales tax from customers and fails to timely remit the tax to the state, it will be presumed that the taxpayer intended to defraud the state. In such cases, the state will impose a higher penalty and immediately pursue collection of the amounts the taxpayer collected from customers.
2. **The April 19, 2005 amendments** would clarify that the rebuttable presumption applies to the burden of producing evidence.
3. **Customers entrust retailers to remit the tax to the State.** Proponents note that sales taxes are generally regarded by customers as "fiduciary taxes" or "trust taxes." The customers perceive the tax reimbursement they pay to retailers as the State's money, not the retailers'. While the true liability for the tax falls on a retailer, customers who pay sales tax to the retailer trust and expect the retailer to send it to the state; otherwise they would have no obligation to reimburse the retailer. When sales tax reimbursement is collected from a customer, the customers' perception is that the business is, in effect, acting as the agent for the state or local government, collecting the government's money from the customer and then paying it over to the government on a periodic basis. A failure of the business to do so should be recognized as fraudulent in the law.
4. **Failing to report tax reimbursement is clearly fraudulent, absent a clerical error.** Proponents note that the act of collecting tax reimbursement and failing to remit the tax to the state is distinctively different than other badges of fraud and should result in an automatic fraud penalty and jeopardy determination. With other badges of fraud, the Board has to draw inferences regarding a taxpayer's state of mind and weigh the circumstantial evidence to determine whether other behaviors are fraudulent. The act of collecting tax reimbursement and failing to remit it to the state is clearly a factual behavior that can only be rebutted by a clerical error.

5. **Some observers believe the legislation is unnecessary.** Current Board guidelines provide that any assertion of fraud must be supported by one or more of the eight badges of fraud. One of the badges of fraud is when a retailer knowingly collects sales tax reimbursement from customers and fails to remit the tax to the Board.

6. **Some argue that the burden of proof shifts to the taxpayer to prove he or she wasn't acting fraudulently.** Some observers have noted that this bill appears to shift the burden of proof from Board to the taxpayer only when the allegation of fraud is based on the taxpayer collecting tax reimbursement and not remitting the tax to the Board.

   Observers note that California law currently requires the Board bear the burden of proving by clear and convincing evidence that a taxpayer is guilty of civil fraud. The courts have consistently held that fraud may never be presumed and must be established by proof. The presumption when fraud is alleged is always in favor of good faith and innocence on part of the taxpayer. Some observers believe that this bill attempts to weaken the standard of proof for imposing fraud penalties.

7. **Some have expressed concern that the jeopardy determination provisions could place a burden on taxpayers.** Observers note that the provisions of the bill that would require an automatic jeopardy determination to be issued could create a serious financial burden on taxpayers.

8. **Related legislation.** SB 633 (Dutton) would, among other things, amend the Evidence Code to provide that in any proceeding to which the Board is a party, the burden of proof is with the Board in any assertion of penalties for intent to evade or fraud and requires a clear and convincing evidence standard for such assertions, as specified.

COST ESTIMATE

Enactment of this bill could increase the Board's workload to the extent that an increase in issuing jeopardy determinations and administrative hearings would occur. However, the increase in workload would likely be offset by the increased revenues attributable to the 25 percent penalty.

REVENUE ESTIMATE

Enactment of this bill could increase compliance with the Sales and Use Tax Law, thereby increasing revenues. However, the magnitude of this increase is unknown.

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