



STATE BOARD OF EQUALIZATION

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State Controller

CYNTHIA BRIDGES
Executive Director

October 16, 2015

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for proposed amendments to Regulation 1668, *Sales for Resale*, which will be presented at the Board's October 27, 2015 Business Taxes Committee meeting. The proposed amendments interpret, clarify and make specific the recent legislation regarding persons convicted of selling or purchasing counterfeit goods.

Please feel free to publish this information on your website or otherwise distribute it to your associates, members, or other persons that may be interested in this issue.

Thank you for your input on these issues and I look forward to seeing you at the Business Taxes Committee meeting at **10:00 a.m. on October 27, 2015** in Room 121 at the address shown above.

Sincerely,

Susanne Buehler, Chief
Tax Policy Division
Sale and Use Tax Department

SB:map

Enclosures

cc: (all with enclosures, via email and/or hardcopy as requested)
Honorable Jerome E. Horton, Chairman, Third District
Senator George Runner (Ret.), Vice Chair, First District
Honorable Fiona Ma, CPA, Member, Second District
Honorable Diane L. Harkey, Member, Fourth District
Honorable Betty T. Yee, State Controller, c/o Ms. Yvette Stowers (MIC 73)

Ms. Kari Hammond, Board Member's Office, Third District
Ms. Shellie Hughes, Board Member's Office, Third District
Mr. Sean Wallentine, Board Member's Office, First District
Mr. Lee Williams, Board Member's Office, First District
Mr. Brian Wiggins, Board Member's Office, First District
Mr. Cary Huxsoll, Board Member's Office, First District
Mr. Alfred Buck, Board Member's Office, First District
Mr. Jim Kuhl, Board Member's Office, Second District
Ms. Kathryn Asprey, Board Member's Office, Second District
Mr. John Vigna, Board Member's Office, Second District
Mr. Tim Morland, Board Member's Office, Second District
Ms. Lizette Mata, Board Member's Office, Second District
Mr. Russell Lowery, Board Member's Office, Fourth District
Mr. Ted Matthies, Board Member's Office, Fourth District
Ms. Lisa Renati, Board Member's Office, Fourth District
Mr. Clifford Oakes, Board Member's Office, Fourth District
Ms. Lynne Kinst, Board Member's Office, Fourth District
Mr. Ramon Salazar, State Controller's Office (MIC 73)
Ms. Cynthia Bridges (MIC 73)
Mr. Randy Ferris (MIC 83)
Mr. David Gau (MIC 101)
Ms. Lynn Bartolo (MIC 43)
Mr. Todd Gilman (MIC 70)
Mr. Wayne Mashihara (MIC 47)
Mr. Kevin Hanks (MIC 49)
Mr. Mark Durham (MIC 67)
Mr. Robert Tucker (MIC 82)
Mr. Jeff Vest (MIC 85)
Mr. Jeff Angeja (MIC 85)
Mr. David Levine (MIC 85)
Mr. Bradley Heller (MIC 82)
Mr. Lawrence Mendel (MIC 82)
Mr. John Thiella (MIC 73)
Ms. Pam Mash (MIC 82)
Ms. Kirsten Stark (MIC 50)
Mr. Marc Alviso (MIC 101)
Mr. Chris Lee (MIC 101)
Ms. Laureen Simpson (MIC 70)
Ms. Karina Magana (MIC 47)
Mr. Bradley Miller (MIC 92)
Mr. Bill Benson (MIC 67)
Mr. Joe Fitz (MIC 67)
Mr. Robert Wilke (MIC 50)
Mr. Michael Patno (MIC 50)

Agenda – October 27, 2015 Business Taxes Committee Meeting
Regulation 1668, *Sales for Resale*

<p>Action 1 – Agreed Upon Items</p> <p>Agenda, pages 2 - 9.</p>	<p>Alternative 1</p> <p>Approve and authorize publication of proposed amendments to Regulation 1668.</p> <p style="text-align: center;">OR</p> <p>Alternative 2</p> <p>Do not approve the proposed amendments to Regulation 1668.</p>
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Agenda – October 27, 2015 Business Taxes Committee Meeting
Regulation 1668, Sales for Resale

Action Item	Staff and Industry's Proposed Regulatory Language
<p>Action 1 – Staff Recommendation</p>	<p>§ 1668. Sales for Resale.</p> <p>Note: Authority cited: Section 7051, Revenue and Taxation Code.</p> <p>Reference: Sections <u>6007</u>, <u>6009.2</u>, <u>6012.8</u>, <u>6012.9</u>, <u>6072</u>, <u>6091-6095</u>, <u>6241-6245</u>, <u>6484</u>, <u>6485</u> and <u>7153</u>, Revenue and Taxation Code.</p> <p>(a) Resale Certificate.</p> <p>The burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a certificate from the purchaser that the property is purchased for resale. If timely taken in proper form as set forth in subdivision (b) and in good faith from a person who is engaged in the business of selling tangible personal property and who holds a California seller's permit as required by Regulation 1699, "PermitsPermits,"²² the certificate relieves the seller from liability for the sales tax and the duty of collecting the use tax. A certificate will be considered timely if it is taken at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or any time at or prior to delivery of the property to the purchaser. A resale certificate remains in effect until revoked in writing.</p> <p>(b) Form of Certificate.</p> <p>(1) Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a resale certificate with respect to the sale of the property described in the document if it contains all of the following essential elements:</p> <p>(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.</p> <p>(B) The name and address of the purchaser.</p> <p>(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g.,</p>

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Action Item	Staff and Industry's Proposed Regulatory Language
	<p>food products for human consumption, or because the purchaser makes no sales in this stateState, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.</p> <p>(D) A statement that the property described in the document is purchased for resale. The document must contain the phrase “for resale.” The use of phrases such as “nontaxable,” “exempt,” or similar terminology is not acceptable. The property to be purchased under the certificate must be described either by an itemized list of the particular property to be purchased for resale, or by a general description of the kind of property to be purchased for resale.</p> <p>(E) Date of execution of document. (An otherwise valid resale certificate will not be considered invalid solely on the ground that it is undated.)</p> <p>(2) A document containing the essential elements described in subdivision (b)(1) is the minimum form which will be regarded as a resale certificate. However, in order to preclude potential controversy, the seller should timely obtain from the purchaser a certificate substantially in the form shown in Appendix A of this regulation. If a purchaser operates an auto body repair and/or paint business, a specific resale certificate in substantially the same form as shown in Appendix B of this regulation should be used, rather than the general resale certificate shown in Appendix A.</p> <p>(3) Blanket Resale Certificate. If a purchaser issues a general (blanket) resale certificate which provides a general description of the items to be purchased, and subsequently issues a purchase order which indicates that the transaction covered by the purchase order is taxable, the resale certificate does not apply with respect to that transaction. However, the purchaser will bear the burden of establishing either that the purchase order was sent to and received by the seller within the seller's billing cycle or prior to delivery of the property to the purchaser (whichever is the later), or that the tax or tax reimbursement was paid to the seller. The purchaser may avoid this burden by using the procedures described in subdivision (b)-(4) below.</p> <p>(4) Qualified Resale Certificate. If a purchaser wishes to designate on each purchase order whether the property being purchased is for resale, the seller should obtain a qualified resale certificate, i.e., one that states “see purchase order” in the space provided for a description of the property to be purchased. Each purchase order must then specify whether or not the property covered by the order is purchased</p>

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	<p>for resale. The use of the phrases “for resale,” “resale = yes,” “nontaxable,” “taxable = no,” or similar terminology on a purchase order, indicating that tax or tax reimbursement should not be added to the sales invoice will be regarded as designating that the property described is purchased for resale provided the combination of the purchase order and the qualified resale certificate contains all the essential elements provided in subdivision (b)(1). However, a purchase order where the applicable amount of tax is shown as \$0 or is left blank will not be accepted as designating that the property is purchased for resale, unless the purchase order also includes the phrase “for resale” or other terminology described above to specify that the property is purchased for resale. If each purchase order does not so specify, or is not issued timely within the meaning of subdivision (a), it will be presumed that the property covered by that purchase order was not purchased for resale and that sale or purchase is subject to tax. If the purchase order includes both items to be resold and items to be used, the purchase order must specify which items are purchased for resale and which items are purchased for use. For example, a purchase order issued for raw materials for resale and also for tooling used to process the raw materials should specify that the raw materials are purchased for resale and that the sale of the tooling is subject to tax.</p> <p>The seller shall retain copies of the purchase orders along with the qualified resale certificates in order to support the sales for resale.</p> <p>(5) If the seller does not timely obtain a resale certificate, the fact that the purchaser deletes the tax or tax reimbursement from the seller's billing, provides a seller's permit number to the seller, or informs the seller that the transaction is “not taxable” does not relieve the seller from liability for the tax nor from the burden of proving the sale was for resale.</p> <p>(c) Good Faith. In absence of evidence to the contrary, a seller will be presumed to have taken a resale certificate in good faith if the resale certificate contains the essential elements as described in subdivision (b)(1) and otherwise appears to be valid on its face. If the purchaser insists that the purchaser is buying for resale property of a kind not normally resold in the purchaser's business, the seller should require a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business.</p> <p>(d) Improper Use of Certificate. Except when a resale certificate is issued in accordance with subdivisions (h), or (i) or (j):</p>

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Action Item	Staff and Industry's Proposed Regulatory Language
	<p>(1) A purchaser, including any officer or employee of a corporation, is guilty of a misdemeanor punishable as provided in section 7153 if the purchaser, for the purpose of evading payment to the seller of tax or tax reimbursement, gives a resale certificate for property which the purchaser knows at the time of purchase will be used rather than resold.</p> <p>(2) Any person, including any officer or employee of a corporation, who gives a resale certificate for property which he or she knows at the time of purchase is not to be resold by him or her or the corporation in the regular course of business is liable to the state for the amount of tax that would be due if he or she had not given such resale certificate. In addition to the tax, the person shall be liable to the state for a penalty of 10 percent of the tax or five hundred dollars (\$500), whichever is greater, for each purchase made for personal gain or to evade the payment of taxes, as provided in sections 6072 and 6094.5.</p> <p>(3) In addition to the penalty of 10 percent or five hundred dollars (\$500), whichever is greater, if the person fails to report and pay the use tax due on the use of the property purchased improperly with a resale certificate, the person may be liable for the 10 percent penalty for negligence or the 25 percent penalty for fraud, as provided in sections 6484 and 6485.</p> <p>(e) Other Evidence to Rebut Presumption of Taxability. A sale for resale is not subject to sales tax. A person who purchases property for resale and who subsequently uses the property owes tax on that use. A resale certificate which is not timely taken is not retroactive and will not relieve the seller of the liability for the tax. Consequently, if the seller does not timely obtain a resale certificate containing the essential elements as described in subdivision (b)(1), the seller will be relieved of liability for the tax only where the seller shows that the property:</p> <p>(1) Was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, or</p> <p>(2) Is being held for resale by the purchaser and has not been used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, or</p> <p>(3) Was consumed by the purchaser and tax was reported directly to the Board by the purchaser on the purchaser's sales and use tax return, or</p>

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	<p>(4) Was consumed by the purchaser and tax was paid to the Board by the purchaser pursuant to an assessment against or audit of the purchaser developed either on an actual basis or test basis.</p> <p>(f) Use of XYZ Letters. A seller who does not timely obtain a resale certificate may use any verifiable method of establishing that it should be relieved of liability for tax under subdivision (e). One method that the Board authorizes to assist a seller in satisfying its burden that the sale was for resale or that tax was paid, is the use of “XYZ letters.” XYZ letters are letters in a form approved by the Board which are sent to some or all of the seller's purchasers inquiring as to the purchaser's disposition of the property purchased from the seller. An XYZ letter will include certain information and request responses to certain questions, set forth below. The XYZ letter may also be further customized by agreement between the Board's staff and the seller to reflect the seller's particular circumstances.</p> <p>(1) An XYZ letter may include the following information: seller's name and permit number, date of invoice(s), invoice number(s), purchase order number(s), amount of purchase(s), and a description of the property purchased or other identifying information. A copy of the actual invoice(s) may be attached to the XYZ letter. The XYZ letter will request the purchaser to complete the statement and include the purchaser's name, seller's permit number and nature of the purchaser's business. The statement shall be signed by the purchaser, purchaser's employee or authorized representative, and include the printed name of <u>the</u> person signing the certificate, title, date, telephone number and city.</p> <p>(2) An XYZ letter will request that the purchaser, purchaser's employee or authorized representative check one of the boxes provided inquiring as to whether the property in question was:</p> <p>(A) Purchased for resale and resold in the form of tangible personal property, without any use other than retention, demonstration, or display while being held for sale in the regular course of business;</p> <p>(B) Purchased for resale and presently in resale inventory, without having been used for any purpose other than retention, demonstration, or display while being held for sale in the regular course of business;</p> <p>(C) Purchased solely for leasing and was so leased. Tax has been paid directly to the Board measured by the purchase price or rental receipts (-“tangible personal property”); or tax has been paid measured by the purchase price or fair rental value (-“mobile transportation equipment”).</p> <p>(D) Purchased for resale but consumed or used (whether or not subsequently resold); or</p>

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	<p>(E) Purchased for use.</p> <p>(F) When the purchaser answers either (D) or (E) affirmatively (box checked), the XYZ letter will inquire further whether:</p> <ol style="list-style-type: none"> 1. The tax was paid directly to the Board on the purchaser's Sales and Use Tax Return, and if so, in what amount; 2. The tax was added to the billing of the seller and remitted to the seller, and if so, in what amount; 3. The tax was paid directly to the Board by the purchaser pursuant to an assessment against or audit of the purchaser developed either on an actual basis or test basis; 4. The purchaser confirms that the purchase is a taxable transaction and that tax is applicable. <p>(3) A response to an XYZ letter is not equivalent to a timely and valid resale certificate. A purchaser responding affirmatively to questions reflected in paragraphs (A), (B), (C), or (D) of subdivision (f)(2) will be regarded as confirming the seller's belief that a sale was for resale for purposes of subdivision (g). However, the Board is not required to relieve a seller from liability for sales tax or use tax collection based on a response to an XYZ letter. The Board may, in its discretion, {verify the information provided in the response to the XYZ letter,} including making additional contact with the purchaser or other persons to determine whether the purchase was for resale or for use {or whether tax was paid by the purchaser.} When the Board accepts the purchaser's response to an XYZ letter as a valid response, the Board shall relieve the seller of liability for sales tax or use tax collection.</p> <p>(4) When there is no response to an XYZ letter, the Board staff should consider whether it is appropriate to use an alternative method to ascertain whether the seller should be relieved of tax under subdivision (e) with respect to the questioned or unsupported transaction(s).</p> <p>(g) Purchaser's Liability for Tax. A purchaser who issues a resale certificate containing the essential elements as described in subdivision (b)(1) and that otherwise appears valid on its face, or who otherwise purchases tangible personal property that is accepted by the Board as purchased for resale pursuant to subdivision (f) and who thereafter makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business is liable for use tax on the cost of the property. The tax is due at the time the property is first stored or used and must be reported and paid by the purchaser with the purchaser's tax return for the period in which the</p>

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	<p>property is first so stored or used. A purchaser cannot retroactively rescind or revoke a resale certificate and thereby cause the transaction to be subject to sales tax rather than use tax.</p> <p>A purchaser who issues a resale certificate for property which the purchaser knows at the time of purchase is not to be resold in the regular course of business is liable for the sales tax on that purchase measured by the gross receipts from the sale to that purchaser. The tax is due as of the time the property was sold to the purchaser and must be reported and paid by the purchaser with the purchaser's tax return for the period in which the property was sold to the purchaser.</p> <p>(h) Mobilehomes. A mobilehome retailer who purchases a new mobilehome for sale to a customer for installation for occupancy as a residence on a foundation system pursuant to Section<u>section</u> 18551 of the Health and Safety Code, or for installation for occupancy as a residence pursuant to Section<u>section</u> 18613 of the Health and Safety Code, and which mobilehome is thereafter subject to property taxation, may issue a resale certificate to the mobilehome vendor even though the retailer is classified as a consumer of the mobilehome by Sections<u>sections</u> 6012.8 and 6012.9 of the Revenue and Taxation Code. Also, effective September 19, 1985,a mobilehome retailer, licensed as a mobilehome dealer under Section<u>section</u> 18002.6 of the Health and Safety Code, who purchases a new mobilehome for sale to a customer for installation for occupancy as a residence on a foundation system pursuant to Section<u>section</u> 18551 of the Health and Safety Code, may issue a resale certificate to the mobilehome vendor even though the mobilehome retailer may have the mobilehome installed on a foundation system as an improvement to realty prior to the retailer's sale of the mobilehome to the customer for occupancy as a residence.</p> <p>Where the mobilehome is acquired by a mobilehome retailer, who is not licensed as a dealer pursuant to Section<u>section</u> 18002.6 of the Health and Safety Code, for affixation by the retailer to a permanent foundation, or for other use or consumption (except demonstration or display while holding for sale in the regular course of business), prior to sale, the mobilehome retailer may not issue a resale certificate. The mobilehome retailer shall notify the vendor that the purchase is for consumption and not for resale. When a mobilehome manufacturer or other vendor is informed or has knowledge that the purchaser will install the mobilehome on a permanent foundation prior to its resale, the manufacturer or other vendor is not making a sale for resale. Such vendor is making a taxable retail sale and cannot accept a resale certificate in good faith.</p>

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Action Item	Staff and Industry's Proposed Regulatory Language
	<p>(i) Mobile Transportation Equipment. Any person, other than a person exempt from use tax, such as under Revenue and Taxation Code section 6352, who purchases mobile transportation equipment for the sole purpose of leasing that equipment, may issue a resale certificate for the limited purpose of reporting use tax based on fair rental value as provided in Regulation 1661.</p> <p><u>(j) Counterfeit Goods. A sale of tangible personal property with a counterfeit mark on, or in connection with, that sale by a convicted seller is included in the definition of “retail sale” per Revenue and Taxation Code section 6007, and therefore taxable. “Storage” and “use” as defined in Revenue and Taxation Code section 6009.2, includes any purchase of tangible personal property with a counterfeit mark on, or in connection with, that purchase by a convicted purchaser and is subject to tax. This is regardless of whether the counterfeit goods were sold for resale or held with the intent to be resold. A “counterfeit mark” is a spurious mark that is used in a manner described in section 2320 of Title 18 of the United States Code.</u></p>

Issue Paper Number **15-008**



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

Regulation 1668, *Sales for Resale*

I. Issue

Whether the Board should amend Regulation 1668, *Sales for Resale*, to interpret, clarify and make specific the recent legislation regarding persons convicted of selling or purchasing counterfeit goods.

II. Alternative 1 - Staff Recommendation

Staff recommends approval and authorization to publish the proposed amendments to Regulation 1668, as set forth in Exhibit 2, to clarify Revenue and Taxation Code (RTC) §6009.2 and amended RTC §6007.

III. Alternative 2

Do not approve the proposed amendments to Regulation 1668.

Issue Paper Number 15-008

IV. Background

Assembly Bill (AB) 2681 (Stats. 2014, Ch. 477), establishes that any sale by a convicted seller or purchase by a convicted purchaser of counterfeit goods is subject to tax. This paper provides a general overview of the new legislation and includes staff's recommended regulatory language for proposed rulemaking.

General

The RTC provides that sales tax is imposed on the gross receipts from the retail sale of tangible personal property in this state, unless the sale is specifically exempt from taxation by statute. The sales tax is imposed upon the retailer for the privilege of selling tangible personal property at retail in California. When sales tax does not apply, use tax is imposed on the storage, use, or other consumption of tangible personal property purchased from a retailer unless specifically exempted or excluded by statute. The obligation to pay the use tax is on the consumer.

RTC §6007 defines the terms "retail sale" or "sale at retail" to mean a sale for any purpose other than resale in the regular course of business in the form of tangible personal property. RTC §6008 and §6009 define "storage" and "use," respectively. "Storage" includes any keeping or retention in this state for any purpose except sale in the regular course of business or subsequent use solely outside this state of tangible personal property purchased from a retailer. "Use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property, and also includes the possession of, or the exercise of any right or power over, tangible personal property by a lessee under a lease, except that it does not include the sale of that property in the regular course of business.

Regulation 1668, Sales for Resale

A seller can overcome the presumption of taxability by timely taking a resale certificate in good faith from a purchaser as provided in Regulation 1668. A resale certificate, if taken timely and in good faith, will relieve the seller of the liability for the sales tax. A seller is presumed to have taken a resale certificate in good faith in the absence of evidence to the contrary. Regulation 1668 also provides that the seller should obtain a resale certificate in substantially the same form as that provided in Regulation 1668.

Assembly Bill 2681

Effective September 19, 2014, AB 2681 amended RTC §6007 and enacted RTC §6009.2. The statutory changes took effect immediately as AB 2681 was passed as a tax levy. It adds to the definition of "retail sale" any sale by a convicted seller of tangible personal property with a counterfeit mark on, or in connection with, that sale, regardless of whether the sale is for resale in the regular course of business. Similarly, the bill adds to the definition of "storage" and "use" any purchase by a convicted purchaser of tangible personal property with a counterfeit mark on, or in connection with, that purchase, regardless of whether the purchase is for resale. Therefore, sales and purchases of counterfeit goods by a convicted person are subject to tax, including claimed resale transactions.

V. Discussion

Staff drafted proposed revisions to Regulation 1668 to clarify the changes that AB 2681 enacted. One interested parties meeting was held to discuss the proposed regulatory amendments. At the meeting, staff's recommendations were well received and no submissions from interested parties with alternative language were received.

Sales and Purchases Involving Counterfeit Goods

FORMAL ISSUE PAPER

Prior to the passage of AB 2681, a person found guilty of selling counterfeit merchandise would be able to claim qualified transactions as sales for resale for sales and use tax purposes. Similarly, a person found guilty of possessing counterfeit merchandise in inventory could claim the products were purchased for resale and thus not subject to sales or use tax.

AB 2681 makes a sale or purchase of counterfeit goods by a convicted seller or purchaser subject to tax. The transactions are taxable regardless of whether the sale or purchase was for resale. In addition, it does not matter if the person convicted is the manufacturer, wholesaler, distributor, or retailer of the counterfeit goods. A “convicted seller” or “convicted purchaser” is a person convicted of a violation under §2320 of Title 18 of United States Code (USC) or under §350 or §653w of the Penal Code. The term “counterfeit mark” is used for both state and federal convictions when defining a convicted seller or purchaser. AB 2681 states a counterfeit mark has the same meaning as found in §2320 of Title 18 of the USC.

Staff proposes to add a new subdivision (j), *Counterfeit Goods*, to Regulation 1668. The language will clarify that convicted sellers are no longer able to claim their sales of counterfeit goods as nontaxable sales for resale. It also states that purchases of counterfeit goods by convicted purchasers are considered for storage and use and are subject to tax. (See Exhibit 2).

Improper Use of a Resale Certificate

Regulation 1668 imposes a penalty of ten percent or five hundred dollars, whichever is greater, for each misuse of a resale certificate by a person who, at the time it is issued, knows the inventory will not be resold in the regular course of business. Staff considered whether this penalty could apply in instances where a seller provided a resale certificate for purchases of counterfeit inventory and was subsequently convicted of purchasing counterfeit goods. It was determined that this penalty is duplicative of the penalty imposed by AB 2681 (i.e., the disallowance of a resale exemption) and would not apply. Therefore, staff has inserted a reference to counterfeit goods in subdivision (d), *Improper Use of Certificate*, that provides an exception from the penalties described in that part of the regulation. The proposed reference is in keeping with the existing exceptions for mobilehomes and mobile transportation equipment which are referenced in subdivisions (h) and (i), respectively.

VI. Alternative 1 - Staff Recommendation

A. Description of Alternative 1

Staff recommends approval and authorization to publish the proposed amendments to Regulation 1668, as set forth in Exhibit 2, to clarify RTC §6009.2 and amended RTC §6007.

B. Pros of Alternative 1

The proposed language is concise and leaves no room for ambiguity by stating sales or purchases of counterfeit goods by a convicted seller or purchaser are subject to tax regardless if their intentions were to resell them. In addition, the proposed revisions clarify that convicted sellers or purchasers will not be assessed penalties related to resale misuse involving the counterfeit goods on which their convictions were based.

C. Cons of Alternative 1

None.

D. Statutory or Regulatory Change for Alternative 1

Staff’s recommendation requires a regulatory change. No statutory change is required.

E. Operational Impact of Alternative 1

Staff will publish the proposed amendments to Regulation 1668 and thereby begin the formal rulemaking process.

F. Administrative Impact of Alternative 1

1. Cost Impact

The workload associated with publishing the revised regulation and updating the BOE webpage is considered routine. Any corresponding cost would be absorbed within the BOE's existing budget.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 1

Convicted sellers and purchasers can no longer claim a sale or purchase of a counterfeit good as a resale transaction and their counterfeit inventory sold or purchased would now be subject to tax. Staff advised taxpayers of the change of the law by publishing a Special Notice and articles in the Tax Information Bulletin and the News for Tax Practitioners.

H. Critical Time Frames of Alternative 1

The provisions enacted by AB 2681 became operative upon its passage and approval by the governor. Staff anticipates the Office of Administrative Law will complete its review and approval of the regulation revisions by April 2016.

VII. Alternative 2

A. Description of Alternative 2

Do not approve the revisions to Regulation 1668.

B. Pros of Alternative 2

The BOE will not incur the workload associated with publishing the regulation.

C. Cons of Alternative 2

There will be no specific guidance available to the public indicating that sales of counterfeit goods resold or the counterfeit inventory of a convicted seller or purchaser are taxable. In addition, there will be no clarification that additional penalties for misuse of a resale certificate involving counterfeit goods are not to be assessed.

D. Statutory or Regulatory Change for Alternative 2

None.

E. Operational Impact of Alternative 2

None.

FORMAL ISSUE PAPER

F. Administrative Impact of Alternative 2

1. Cost Impact

None.

2. Revenue Impact

None. See Revenue Estimate (Exhibit 1).

G. Taxpayer/Customer Impact of Alternative 2

Without the proposed regulation revisions, there would be no clarification of AB 2681 and the fact that all counterfeit sales and inventory of convicted sellers and purchasers are now subject to tax.

H. Critical Time Frames of Alternative 2

None.

Preparer/Reviewer Information

Prepared by: Tax Policy Division, Sales and Use Tax Department.

Current as of: October 15, 2015

REVENUE ESTIMATE

STATE OF CALIFORNIA
BOARD OF EQUALIZATIONBOARD OF EQUALIZATION
REVENUE ESTIMATE

Proposed Amendments to Regulation 1668, *Sales for Resale*

I. Issue

Whether the Board should amend Regulation 1668, *Sales for Resale*, to interpret, clarify and make specific the recent legislation regarding persons convicted of selling or purchasing counterfeit goods.

The passage of AB 2681 on September 19, 2014, amends Revenue and Taxation Code (RTC) §6007 and creates §6009.2. It adds to the definition of “retail sale” any sale by a convicted seller of tangible personal property with a counterfeit mark on, or in connection with, that sale, regardless of whether the sale is for resale in the regular course of business. Similarly, the bill adds to the definition of “storage” and “use” any purchase by a convicted purchaser of tangible personal property with a counterfeit mark on, or in connection with, that purchase, regardless of whether the purchase is for resale. Therefore, sales and purchases of counterfeit goods by a convicted person are subject to tax, including claimed resale transactions.

II. Alternative 1 - Staff Recommendation

Staff recommends approval and authorization to publish the proposed amendments to Regulation 1668, as set forth in Exhibit 2, to clarify Revenue and Taxation Code (RTC) §6009.2 and amended RTC §6007.

III. Other Alternative(s) Considered

Do not approve the proposed amendments to Regulation 1668.

Background, Methodology, and Assumptions

Alternative 1 – Staff Recommendation

There is nothing in the staff recommendation that would impact revenue. The proposed amendments clarify existing law by stating sales or purchases of counterfeit goods by a convicted seller or purchaser are subject to tax regardless if their intentions were to resell them.

Other Alternatives Considered

There is nothing in Alternative 2 that would impact revenue. However, there would be no specific guidance available to the public indicating that sales of counterfeit goods resold or the counterfeit inventory of a convicted seller or purchaser are taxable.

Revenue Summary

Alternative 1 – staff recommendation does not have a revenue impact.

Other alternatives considered – alternative 2 does not have a revenue impact.

Preparation

Mr. Joe Fitz, Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. This estimate has been reviewed by Mr. Mark Durham, Manager, Research and Statistics Section, Legislative and Research Division, and by Ms. Susanne Buehler, Chief, Tax Policy Division, Sales and Use Tax Department. For additional information, please contact Mr. Fitz at (916) 445-0840.

Current as of October 15, 2015.

§ 1668. Sales for Resale.

Note: Authority cited: Section 7051, Revenue and Taxation Code.

Reference: Sections [6007](#), [6009.2](#), 6012.8, 6012.9, 6072, 6091-6095, 6241-6245, 6484, 6485 and 7153, Revenue and Taxation Code.

(a) Resale Certificate.

The burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes in good faith a certificate from the purchaser that the property is purchased for resale. If timely taken in proper form as set forth in subdivision (b) and in good faith from a person who is engaged in the business of selling tangible personal property and who holds a California seller's permit as required by Regulation 1699, ~~“Permits~~Permits,” the certificate relieves the seller from liability for the sales tax and the duty of collecting the use tax. A certificate will be considered timely if it is taken at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or any time at or prior to delivery of the property to the purchaser. A resale certificate remains in effect until revoked in writing.

(b) Form of Certificate.

(1) Any document, such as a letter or purchase order, timely provided by the purchaser to the seller will be regarded as a resale certificate with respect to the sale of the property described in the document if it contains all of the following essential elements:

(A) The signature of the purchaser, purchaser's employee, or authorized representative of the purchaser.

(B) The name and address of the purchaser.

(C) The number of the seller's permit held by the purchaser. If the purchaser is not required to hold a permit because the purchaser sells only property of a kind the retail sale of which is not taxable, e.g., food products for human consumption, or because the purchaser makes no sales in this ~~State~~state, the purchaser must include on the certificate a sufficient explanation as to the reason the purchaser is not required to hold a California seller's permit in lieu of a seller's permit number.

(D) A statement that the property described in the document is purchased for resale. The document must contain the phrase “for resale.” The use of phrases such as “nontaxable,” “exempt,” or similar terminology is not acceptable. The property to be purchased under the certificate must be described either by an itemized list of the particular property to be purchased for resale, or by a general description of the kind of property to be purchased for resale.

(E) Date of execution of document. (An otherwise valid resale certificate will not be considered invalid solely on the ground that it is undated.)

(2) A document containing the essential elements described in subdivision (b)(1) is the minimum form which will be regarded as a resale certificate. However, in order to preclude potential controversy, the seller should timely obtain from the purchaser a certificate substantially in the form shown in Appendix A of this regulation. If a purchaser operates an auto body repair and/or paint business, a specific resale certificate in substantially the same form as shown in Appendix B of this regulation should be used, rather than the general resale certificate shown in Appendix A.

(3) Blanket Resale Certificate. If a purchaser issues a general (blanket) resale certificate which provides a general description of the items to be purchased, and subsequently issues a purchase order which indicates that the transaction covered by the purchase order is taxable, the resale certificate does not apply with respect to that transaction. However, the purchaser will bear the burden of establishing either that the purchase order was sent to and received by the seller within the seller's billing cycle or prior to delivery of the property to the purchaser (whichever is the later), or that the tax or tax reimbursement was paid to the seller. The purchaser may avoid this burden by using the procedures described in subdivision (b)-(4) below.

(4) Qualified Resale Certificate. If a purchaser wishes to designate on each purchase order whether the property being purchased is for resale, the seller should obtain a qualified resale certificate, i.e., one that states "see purchase order" in the space provided for a description of the property to be purchased. Each purchase order must then specify whether or not the property covered by the order is purchased for resale. The use of the phrases "for resale," "resale = yes," "nontaxable," "taxable = no," or similar terminology on a purchase order, indicating that tax or tax reimbursement should not be added to the sales invoice will be regarded as designating that the property described is purchased for resale provided the combination of the purchase order and the qualified resale certificate contains all the essential elements provided in subdivision (b)(1). However, a purchase order where the applicable amount of tax is shown as \$0 or is left blank will not be accepted as designating that the property is purchased for resale, unless the purchase order also includes the phrase "for resale" or other terminology described above to specify that the property is purchased for resale. If each purchase order does not so specify, or is not issued timely within the meaning of subdivision (a), it will be presumed that the property covered by that purchase order was not purchased for resale and that sale or purchase is subject to tax. If the purchase order includes both items to be resold and items to be used, the purchase order must specify which items are purchased for resale and which items are purchased for use. For example, a purchase order issued for raw materials for resale and also for tooling used to process the raw materials should specify that the raw materials are purchased for resale and that the sale of the tooling is subject to tax.

The seller shall retain copies of the purchase orders along with the qualified resale certificates in order to support the sales for resale.

(5) If the seller does not timely obtain a resale certificate, the fact that the purchaser deletes the tax or tax reimbursement from the seller's billing, provides a seller's permit number to the seller, or informs the seller that the transaction is "not taxable" does not relieve the seller from liability for the tax nor from the burden of proving the sale was for resale.

(c) Good Faith. In absence of evidence to the contrary, a seller will be presumed to have taken a resale certificate in good faith if the resale certificate contains the essential elements as described in subdivision (b)(1) and otherwise appears to be valid on its face. If the purchaser insists that the purchaser is buying for resale property of a kind not normally resold in the purchaser's business, the seller should require a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business.

(d) Improper Use of Certificate. Except when a resale certificate is issued in accordance with subdivisions (h), ~~(i)~~ or (j):

(1) A purchaser, including any officer or employee of a corporation, is guilty of a misdemeanor punishable as provided in section 7153 if the purchaser, for the purpose of evading payment to the seller of tax or tax reimbursement, gives a resale certificate for property which the purchaser knows at the time of purchase will be used rather than resold.

(2) Any person, including any officer or employee of a corporation, who gives a resale certificate for property which he or she knows at the time of purchase is not to be resold by him or her or the corporation in the regular course of business is liable to the state for the amount of tax that would be due if he or she had not given such resale certificate. In addition to the tax, the person shall be liable to the state for a penalty of 10 percent of the tax or five hundred dollars (\$500), whichever is greater, for each purchase made for personal gain or to evade the payment of taxes, as provided in sections 6072 and 6094.5.

(3) In addition to the penalty of 10 percent or five hundred dollars (\$500), whichever is greater, if the person fails to report and pay the use tax due on the use of the property purchased improperly with a resale certificate, the person may be liable for the 10 percent penalty for negligence or the 25 percent penalty for fraud, as provided in sections 6484 and 6485.

(e) Other Evidence to Rebut Presumption of Taxability. A sale for resale is not subject to sales tax. A person who purchases property for resale and who subsequently uses the property owes tax on that use. A resale certificate which is not timely taken is not retroactive and will not relieve the seller of the liability for the tax. Consequently, if the seller does not timely obtain a resale certificate containing the essential elements as described in subdivision (b)(1), the seller will be relieved of liability for the tax only where the seller shows that the property:

(1) Was in fact resold by the purchaser and was not used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, or

(2) Is being held for resale by the purchaser and has not been used by the purchaser for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business, or

(3) Was consumed by the purchaser and tax was reported directly to the Board by the purchaser on the purchaser's sales and use tax return, or

(4) Was consumed by the purchaser and tax was paid to the Board by the purchaser pursuant to an assessment against or audit of the purchaser developed either on an actual basis or test basis.

(f) Use of XYZ Letters. A seller who does not timely obtain a resale certificate may use any verifiable method of establishing that it should be relieved of liability for tax under subdivision (e). One method that the Board authorizes to assist a seller in satisfying its burden that the sale was for resale or that tax was paid, is the use of "XYZ letters." XYZ letters are letters in a form approved by the Board which are sent to some or all of the seller's purchasers inquiring as to the purchaser's disposition of the property purchased from the seller. An XYZ letter will include certain information and request responses to certain questions, set forth below. The XYZ letter may also be further customized by agreement between the Board's staff and the seller to reflect the seller's particular circumstances.

(1) An XYZ letter may include the following information: seller's name and permit number, date of invoice(s), invoice number(s), purchase order number(s), amount of purchase(s), and a description of the property purchased or other identifying information. A copy of the actual invoice(s) may be attached to the XYZ letter. The XYZ letter will request the purchaser to complete the statement and include the purchaser's name, seller's permit number and nature of the purchaser's business. The statement shall be signed by the purchaser, purchaser's employee or authorized representative, and include the printed name of the person signing the certificate, title, date, telephone number and city.

(2) An XYZ letter will request that the purchaser, purchaser's employee or authorized representative check one of the boxes provided inquiring as to whether the property in question was:

(A) Purchased for resale and resold in the form of tangible personal property, without any use other than retention, demonstration, or display while being held for sale in the regular course of business;

(B) Purchased for resale and presently in resale inventory, without having been used for any purpose other than retention, demonstration, or display while being held for sale in the regular course of business;

(C) Purchased solely for leasing and was so leased. Tax has been paid directly to the Board measured by the purchase price or rental receipts (“tangible personal property”); or tax has been paid measured by the purchase price or fair rental value (-“mobile transportation equipment”).

(D) Purchased for resale but consumed or used (whether or not subsequently resold); or

(E) Purchased for use.

(F) When the purchaser answers either (D) or (E) affirmatively (box checked), the XYZ letter will inquire further whether:

1. The tax was paid directly to the Board on the purchaser's Sales and Use Tax Return, and if so, in what amount;
2. The tax was added to the billing of the seller and remitted to the seller, and if so, in what amount;
3. The tax was paid directly to the Board by the purchaser pursuant to an assessment against or audit of the purchaser developed either on an actual basis or test basis;
4. The purchaser confirms that the purchase is a taxable transaction and that tax is applicable.

(3) A response to an XYZ letter is not equivalent to a timely and valid resale certificate. A purchaser responding affirmatively to questions reflected in paragraphs (A), (B), (C), or (D) of subdivision (f)(2) will be regarded as confirming the seller's belief that a sale was for resale for purposes of subdivision (g). However, the Board is not required to relieve a seller from liability for sales tax or use tax collection based on a response to an XYZ letter. The Board may, in its discretion, verify the information provided in the response to the XYZ letter, including making additional contact with the purchaser or other persons to determine whether the purchase was for resale or for use for whether tax was paid by the purchaser. When the Board accepts the purchaser's response to an XYZ letter as a valid response, the Board shall relieve the seller of liability for sales tax or use tax collection.

(4) When there is no response to an XYZ letter, the Board staff should consider whether it is appropriate to use an alternative method to ascertain whether the seller should be relieved of tax under subdivision (e) with respect to the questioned or unsupported transaction(s).

(g) Purchaser's Liability for Tax. A purchaser who issues a resale certificate containing the essential elements as described in subdivision (b)(1) and that otherwise appears valid on its face, or who otherwise purchases tangible personal property that is accepted by the Board as purchased for resale pursuant to subdivision (f) and who thereafter makes any storage or use of

the property other than retention, demonstration, or display while holding it for sale in the regular course of business is liable for use tax on the cost of the property. The tax is due at the time the property is first stored or used and must be reported and paid by the purchaser with the purchaser's tax return for the period in which the property is first so stored or used. A purchaser cannot retroactively rescind or revoke a resale certificate and thereby cause the transaction to be subject to sales tax rather than use tax.

A purchaser who issues a resale certificate for property which the purchaser knows at the time of purchase is not to be resold in the regular course of business is liable for the sales tax on that purchase measured by the gross receipts from the sale to that purchaser. The tax is due as of the time the property was sold to the purchaser and must be reported and paid by the purchaser with the purchaser's tax return for the period in which the property was sold to the purchaser.

(h) Mobilehomes. A mobilehome retailer who purchases a new mobilehome for sale to a customer for installation for occupancy as a residence on a foundation system pursuant to ~~Section-section~~ 18551 of the Health and Safety Code, or for installation for occupancy as a residence pursuant to ~~Section-section~~ 18613 of the Health and Safety Code, and which mobilehome is thereafter subject to property taxation, may issue a resale certificate to the mobilehome vendor even though the retailer is classified as a consumer of the mobilehome by ~~Sections-sections~~ 6012.8 and 6012.9 of the Revenue and Taxation Code. Also, ~~effective September 19, 1985,~~ a mobilehome retailer, licensed as a mobilehome dealer under ~~Section-section~~ 18002.6 of the Health and Safety Code, who purchases a new mobilehome for sale to a customer for installation for occupancy as a residence on a foundation system pursuant to ~~Section-section~~ 18551 of the Health and Safety Code, may issue a resale certificate to the mobilehome vendor even though the mobilehome retailer may have the mobilehome installed on a foundation system as an improvement to realty prior to the retailer's sale of the mobilehome to the customer for occupancy as a residence.

Where the mobilehome is acquired by a mobilehome retailer, who is not licensed as a dealer pursuant to ~~Section-section~~ 18002.6 of the Health and Safety Code, for affixation by the retailer to a permanent foundation, or for other use or consumption (except demonstration or display while holding for sale in the regular course of business), prior to sale, the mobilehome retailer may not issue a resale certificate. The mobilehome retailer shall notify the vendor that the purchase is for consumption and not for resale. When a mobilehome manufacturer or other vendor is informed or has knowledge that the purchaser will install the mobilehome on a permanent foundation prior to its resale, the manufacturer or other vendor is not making a sale for resale. Such vendor is making a taxable retail sale and cannot accept a resale certificate in good faith.

(i) Mobile Transportation Equipment. Any person, other than a person exempt from use tax, such as under Revenue and Taxation Code section 6352, who purchases mobile transportation

equipment for the sole purpose of leasing that equipment, may issue a resale certificate for the limited purpose of reporting use tax based on fair rental value as provided in Regulation 1661.

(j) Counterfeit Goods. A sale of tangible personal property with a counterfeit mark on, or in connection with, that sale by a convicted seller is included in the definition of “retail sale” per Revenue and Taxation Code section 6007, and therefore taxable. “Storage” and “use” as defined in Revenue and Taxation Code section 6009.2, includes any purchase of tangible personal property with a counterfeit mark on, or in connection with, that purchase by a convicted purchaser and is subject to tax. This is regardless of whether the counterfeit goods were sold for resale or held with the intent to be resold. A “counterfeit mark” is a spurious mark that is used in a manner described in section 2320 of Title 18 of the United States Code.