

[Assembly Bill 433](#) (Bocanegra)

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Program: Sales and Use Tax

Sponsor: Author

Revenue and Taxation Code Section 6901

Effective: January 1, 2018

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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. Allows a customer to seek a refund directly from the BOE, if, after 60 days, the retailer denies an election, or the retailer is no longer in business, or the customer cannot locate the retailer.

Summary of Amendments: The amendments since the previous analysis clarify that the \$50,000 threshold refers to \$50,000 of tax.

Purpose: To allow direct reimbursement to a customer who was overcharged sales tax reimbursement.

Fiscal Impact Summary: Potential annual state and local revenue loss of between \$250,000 and \$2,650,000 as a result of additional refunds paid.

Existing Law: Except where the law provides a specific exemption or exclusion, California's Sales and Use Tax Law¹ 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.

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

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.

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 specified 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 from a single retailer 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.

In addition, the bill provides that, if within 60 days of the customer's written request, the retailer denies an assignment, the retailer is no longer in business, or the customer is unable to locate the retailer, then the customer may instead submit a signed statement confirming efforts to obtain the irrevocable assignment.

The bill requires the retailer to make available for BOE inspection records to verify the refund. 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 that paid the tax, amounts paid by a retailer to satisfy liability related to an audit determination, or amounts owed by the customer. The balance will then be refunded to the customer who paid the excess tax reimbursement. The retailer must 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, 2018.

Legislative History: 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 off the Assembly Floor and out of 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.

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.

In 2015, SB 640 (Beall), which was largely identical to AB 43, as amended August 5, 2014, authorized 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 BOE may make a direct refund to the customer. The bill passed out of the Senate Governance and Finance Committee (7-0) and was then referred to the Senate Appropriations Committee. The June 2, 2015 amendments reduced the qualifying refund threshold from \$50,000 to \$1,000. While these amendments substantially increased BOE's administrative costs, the bill passed out of the Senate Appropriations Committee (7-0) and the Senate Floor (40-0).

On August 18, 2015, SB 640 was amended again to eliminate the requirement that a retailer make an irrevocable assignment of the right to file a refund and allow customers to file a refund claim directly with the BOE. These amendments were intended to address instances when a retailer refuses to assign the right to a customer, or when a retailer is no longer in business, or a retailer has moved and the customer cannot locate the retailer. The bill passed out of Assembly Revenue and Taxation Committee (9-0), but was held on the Assembly Appropriations Committee's suspense file.

Commentary:

- 1. The April 3, 2017 amendments** clarify that the amount of excess tax reimbursement to be refunded refers to \$50,000 of tax.
- 2. Effect of the bill.** This bill authorizes a retailer to make an irrevocable election to assign to a customer the right to file a claim for and receive a refund. It also requires the customer to first make a written request to obtain an irrevocable assignment from the retailer. If, within 60 days of the request, the retailer denies the election or the customer cannot locate the retailer, the bill allows the customer seek a refund directly from the BOE.

The BOE's processes to implement this bill would be as follows:

- BOE staff would develop new claim for refund forms, which would also include assignment forms.
- 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 staff would review each refund claim to determine whether it is valid (i.e., claim filed within statute of limitations, claim meets the \$50,000 in tax threshold). Invalid refund claims would be rejected.
- BOE audit staff would verify the retailer's information on the refund form. In cases where the customer fails to provide correct permit information for the retailer, BOE staff would have to search its computer system to identify the retailer and contact the customer to obtain the information if the retailer cannot be located.
- A BOE auditor would request the necessary documentation from the customer to determine that it paid sales tax reimbursement. However, 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 cause delays resulting from the inability to timely 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.

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- Audit staff would amend the retailer's return or returns to create the refund then transfer the refund amount to the customer's account. For customers that do not hold a permit with the BOE, a special (arbitrary) account would have to be created.
 - A database would be developed and maintained by the audit staff. In addition to the customer and retailer's information, each transaction (invoice) must be entered into the database to keep track of who has received a refund for that specific transaction.
- 3. No refund of sales tax can be made until the BOE verifies that the retailer paid the tax to the BOE.** The bill allows the customer to move forward with the claim for refund when (1) the customer cannot locate the retailer, (2) the retailer is no longer in business, or (3) the retailer refuses to make an irrevocable assignment. The bill requires that the retailer make the records to verify the refund available for inspection by the BOE, and prohibits a refund from being paid until the BOE verifies that a refund is properly due. Accordingly, in order to make a refund to the customer, BOE staff must verify that the sales tax was paid to the state.
- 4. Potential issues.** A number of issues can arise when the customer files a claim for refund instead of the retailer.
- **Statute of limitations.** 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).
 - **Appeal rights.** The customer must file a separate appeal for each vendor/retailer. 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.
 - **Threshold.** 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, and one purchase is outside the statute of limitations, then the farmer will not meet the \$50,000 threshold.
 - **Record keeping and access.** Some customers may not hold a permit with the BOE. If the customer does not have the documentation for BOE to validate and approve a refund, the BOE must inspect the retailer's records. Thus, the retailer still must make all the necessary records available for audit as needed, as these records will not be in the customer's possession. This could result in significant delays to schedule the audit or investigation. (National retailers often are audited by many different states. Scheduling audit appointments may take months to coordinate with other audit requests of that retailer.)
 - **Duplication.** A customer filing a refund claim directly with the BOE creates the possibility of issuing duplicate tax refunds. A database to track refunds would be required.
 - **Right to a refund is contingent upon a retailer making the books and records available.** What if the retailer resists or refuses to cooperate? What if the retailer is no longer in business? It is not readily clear how to address these issues. Additionally, staff anticipates the tendency to file fraudulent claims when the retailer is no longer in business and staff cannot verify the refund. BOE staff would expect these situations to increase administrative costs. However, by what amount is difficult to determine.
- 5. A single customer must file separate refund claims for each (single) retailer.** The bill does not authorize a customer to file a claim for refund encompassing excess tax reimbursement that was collected and remitted by multiple retailers. Instead, it would require separate refund claims meeting the threshold. The bill also does not authorize a customer to aggregate the excess tax reimbursement paid to multiple retailers to reach the \$50,000 threshold. Instead, a refund claim may only be made if a single retailer 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 neither the parent company nor its subsidiary can aggregate the subsidiaries' refund claims to reach the \$50,000 threshold.

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6. 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.

7. Administrative and technical concerns:

- **Delayed operative date.** To effectively implement the bill, the BOE must develop an invoice repository to track refunds more carefully, avoid duplicative tax refunds and other issues. In addition, BOE staff would need to modify various screens in registration, returns, and payment subsystems. These functions would need to take place before customers begin filing claims for refund. While the current effective date of January 1, 2018, typically offers sufficient lead time, the BOE requires an additional three months for these changes to be made at the same time that the BOE's Centralized Revenue Opportunity System (CROS) GenTax Rollout 2 goes live. The CROS GenTax R2 is scheduled for implementation on April 1, 2018. Rollout 2 includes the Sales and Use Tax subsystems Registration, Returns, Payments, and Audit. BOE staff suggests a delayed operative date of April 1, 2018, for necessary programming to be made concurrently with the GenTax Rollout 2.
- **Customers' statements signed under penalty of perjury to certify information provided is correct.** Customers that are unable to obtain an assignment are required to submit a statement confirming the efforts to obtain one. These customers would be required to explain in writing why the retailer objects to the assignment and, the actions taken to locate the retailer if the retailer is no longer in business or has moved. BOE staff would consider the customer's statement to determine how to verify the refund. Requiring that the statement be filed under penalty of perjury would allow BOE staff to place greater trust in the statement provided. Current Sales and Use Tax Law provides relief from penalties, collection cost recovery fees, and interest charges. These statutes require that a taxpayer requesting relief file a written statement signed under penalty of perjury to certify that the statements are true and correct.

In addition, BOE staff surveyed several states that authorize an assignment of a right to a tax refund. Some of these states also allow consumers to request a direct refund when the consumer is unable to obtain an assignment from the retailer. With the exception of one state, both retailers and customers are required to submit an assignment or refund application under penalty of perjury.

BOE staff will work with the author's office as the bill progresses to address this concern.

Costs: The estimated preliminary costs to implement the bill include one-time programming costs of approximately \$430,000, first year staff (six positions) and equipment costs of \$870,000, and then \$800,000 annually thereafter. With respect to BOE's one-time programming costs, BOE staff must develop and maintain a database to allow more careful tracking of refunds and to avoid duplicative tax refunds and other issues. Additional programming to BOE's main computer system would be required to modify various registration, payment, and return screen for the retailer's and customer's account to document the refund. Ongoing costs also include six new positions to acknowledge claims, determine eligibility, verify and process refunds, handle partially or fully denied claims, prepare guidelines for staff, and answer questions from retailers and customers.

These are preliminary estimates. A detailed cost estimate is pending.

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

Staff examined claim for refund records for the calendar year 2014, and determined that 528 refunds were processed with excess tax reimbursement in the amount of \$50,000 or more in tax. Staff cannot estimate the number of additional refund claims that would be filed as a result of this bill. However, as an order of magnitude, scenarios of additional 1%, 5%, or 10% claims being filed would result in the following state and local revenue loss:

Additional Refund Claims			
Description	1%	5%	10%
Number of additional refund claims filed	5 (528 refunds X 1%)	26 (528 refunds X 5%)	53 (528 refunds X 10%)
Estimated state and local revenue loss attributable to additional refunds filed	\$250,000 (5 additional refunds X \$50,000)	\$1,300,000 (26 additional refunds X \$50,000)	\$2,650,000 (53 additional refunds X \$50,000)

Qualifying Remark. It should be noted that the revenue loss attributable to additional claims filed represents sales tax reimbursement that was over collected by the retailer and that was not legally due under current Sales And Use Tax Law.

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