



**STATE BOARD OF EQUALIZATION  
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date:	<b>03/19/13</b>	Bill No:	<a href="#"><u>Assembly Bill 1412</u></a>
Tax Program:	<b>Sales and Use Tax</b>	Author:	<b>Committee on Revenue and Taxation</b>
Sponsor:	<b>Author</b>	Code Sections:	<b>RTC 6901</b>
Related Bills:		Effective Date:	<b>01/01/14</b>

**BILL SUMMARY**

This bill authorizes a retailer to make an irrevocable election to assign the right to receive a refund of excess tax reimbursement to a customer so that the Board of Equalization (BOE) may make a direct refund to the customer.

**ANALYSIS**

**CURRENT LAW**

Except where the law provides a specific exemption or exclusion, California Sales and Use Tax Law<sup>1</sup> imposes the sales tax on 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.<sup>2</sup> 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 make note of it in its records, credit the amount to another of the retailer’s BOE liabilities, and refund the balance. Section 6901 also provides that the BOE may refund any balance due to the retailer, to the retailer’s successor, administrator, or executor.

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. 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. To obtain a refund of sales tax, the retailer must submit a claim for refund to the BOE.

The BOE’s Sales and Use Tax Regulation 1700, *Reimbursement for Sales Tax*, interprets Section 6901.5. Under Regulation 1700(b)(2), 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.

<sup>1</sup> Part 1 of Division 2 (commencing with Section 6001) of the Revenue and Taxation Code (RTC).

<sup>2</sup> 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. Under Regulation 1700(b)(3)(B), 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

This bill allows the BOE to refund excess sales tax reimbursement directly to the customer who was overcharged the sales tax reimbursement upon the retailer's irrevocable assignment of the right to receive the refund. The retailer and the customer both would need to sign the irrevocable assignment and submit it to the BOE with the retailer's claim for refund.

If enacted, the bill takes effect on January 1, 2014.

#### COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Committee on Revenue and Taxation to simplify excess tax reimbursement refunds.
2. **Proposed refund process.** The bill allows retailers to assign their right to receive a refund to the customer. Both the retailer and the customer are required to sign a statement authorizing the named customer to receive the amount refunded. The retailer would be required to attach the statement when submitting his or her refund claim to the BOE. After a refund claim has been validated and approved, the BOE would authorize direct payment to the retailer's customer.
3. **BOE's Refund Process.** The current refund process is as follows:
  - a. Retailer files a claim for refund.
  - b. Refund information is entered into BOE's computer system, but retailer's general payment information already was entered upon registration.
  - c. Auditor reviews the claim and performs necessary adjustments to amend retailer's return.
  - d. BOE's computer system automatically calculates any differences (overpayment) between a retailer's revenues and payments.
  - e. After a claim for refund is verified as valid, the retailer's information (name, account number, social security number or federal employer identification number, and refund amount) is transferred onto an electronic spreadsheet.
  - f. The refund is reduced by the amount of the retailer's outstanding tax or fee liability.
  - g. The spreadsheet is transmitted to the State Controller's Office (SCO), and the SCO generates a refund warrant and mails it to the retailer.
  - h. The SCO charges \$0.71 per warrant issued.

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4. **Manual entry or potential new computer system would increase BOE costs.** In processing a claim for refund, the payment process is primarily electronic. The retailer's information to process a payment has already been entered into the system (at the time of registration). Since this bill authorizes a direct payment to the retailer's customer, the customer's information must be entered into the BOE's computer system. The BOE would have to implement procedures for customers who hold a sales or use tax permit and those customers who do not hold a permit. For unregistered recipients, the BOE would have to manually enter the customer's payment information into the system.

Currently, the system automatically issues the refund to the retailer of record. The BOE may, however, under limited circumstances issue a payment to the retailer's successor, administrator, or executor. This is a manual function (referred to as a "bypass" procedure) used by BOE staff under limited circumstances. This method would be used by staff to issue a refund payment directly to the customer. However, the BOE's Technology Services Division is concerned that this function cannot accommodate multiple customers and is evaluating the need for a new, separate system.

5. **Assignments to multiple customers create administrative difficulty.** The following example illustrates the difficulty in refunding to multiple customers. A retailer of irrigation equipment, parts, and supplies sells to ranchers, farmers and other growers who perform activities that are covered under the partial tax exemption for farm equipment and machinery. A rancher and farmer fail to provide an exemption certificate to the retailer when purchasing irrigation supply items, such as sprinkler pipes and drip systems. Therefore, the retailer charges sales tax reimbursement on these items and reports and pays the tax to the BOE. Subsequently, the rancher and farmer request a refund of the excess sales tax reimbursement from the retailer. The retailer files a claim with the BOE and attaches assignment forms involving multiple customers.

Under this example, BOE staff would follow the current guidelines for processing refunds. However, rather than issuing a single payment to the retailer, the BOE would issue payments to multiple customers. BOE would verify customer information and would manually enter it into the system; ranchers and farmers without seller's permits would need separate identification numbers. BOE would compile the information and transfer it onto an electronic spreadsheet to transmit to the SCO.

Although the example above appears relatively simple, retailers could file multiple claims in the same quarterly periods. Moreover, a retailer's return would need to be amended multiple times (once for each claim received) requiring BOE staff to prepare payment information to refund excess tax reimbursement to numerous additional customers.

6. **Other concerns.** BOE staff anticipates the need to process multiple customer, small dollar refund claims. For example, if a retailer incorrectly codes charges for nontaxable repair labor as taxable, excess tax reimbursement would be collected. Rather than refund the excess tax reimbursement directly to its customer, the retailer may elect to assign the right to receive the refund claim to the customer, effectively, delegating payment responsibility to BOE. The customers' payment information would require verification and entry into BOE's system. The volume of small dollar refund payments is expected to be substantial.

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In addition, California voters approved eighteen city sales tax increases effective April 1, 2013. Even though a city's tax rate increase does not apply in the unincorporated area of a county, some retailers in the unincorporated were overcharging sales tax. The BOE staff is concerned that changes in local tax rates could cause retailers to charge the wrong rate and, thus, result in additional filings of excess reimbursement refunds.

7. **Deallocation of local sales taxes and district taxes.** To process a refund claim, BOE would have to 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 have to 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. In order to deallocate the tax, it may be necessary to examine 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 such verification, revenue may be deallocated from the wrong local jurisdiction.
8. **BOE Members voted to sponsor an alternative proposal.** At the January 15, 2013 BOE Legislative Committee Meeting, the Members unanimously voted to support a proposal to authorize a direct refund of excess sales tax reimbursement in the amount of \$300,000 or more to a single customer. To obtain a direct refund, the retailer and customer would both need to sign an irrevocable assignment and submit it to the BOE with the retailer's claim for refund. A threshold and limitation of an assignment to a single customer would greatly reduce BOE's administrative concerns.

## COST ESTIMATE

Costs to implement this bill would be significant. New, non-retailer payees would need to be manually entered into the BOE's computer system. Refunding directly to the retailer's customer will require a major redesign of the BOE's system, including programming to track refunds to avoid duplicate tax refunds. In addition, the BOE would incur costs to notify retailers, create a new assignment form, modify existing forms, prepare a special publication, develop a new regulation and procedures, train staff, and answer numerous taxpayer inquiries. The BOE will also incur costs associated with the SCO's \$0.71 per warrant charge.

An estimate of these costs is pending. However, preliminary costs are expected to be over \$1 million and may be substantially higher.

## REVENUE ESTIMATE

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

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