



STATE OF CALIFORNIA

## STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA  
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0092  
1-916-324-1825 • FAX 1-916-322-4530  
[www.boe.ca.gov](http://www.boe.ca.gov)

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May 22, 2015

Dear Interested Party:

Enclosed is the Initial Discussion Paper on Regulation 1668, *Sales for Resale*. Before the issue is presented at the Board's October 27, 2015 Business Taxes Committee meeting, staff would like to invite you to discuss the issue and present any additional suggestions or comments. Accordingly, an interested parties meeting is scheduled as follows:

**June 2, 2015  
Room 122 at 10:00 a.m.  
450 N Street, Sacramento, CA**

If you would like to participate by teleconference, call 1-888-808-6929 and enter access code 7495412. You are also welcome to submit your comments to me at the address or fax number in this letterhead or via email at [Susanne.Buehler@boe.ca.gov](mailto:Susanne.Buehler@boe.ca.gov) by June 17, 2015. Copies of the materials you submit may be provided to other interested parties, therefore, ensure your comments do not contain confidential information. Please feel free to publish this information on your website or distribute it to others that may be interested in attending the meeting or presenting their comments.

If you are interested in other Business Taxes Committee topics refer to our webpage at (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of discussion or issue papers, minutes, a procedures manual, and calendars arranged according to subject matter and by month.

Thank you for your consideration. We look forward to your comments and suggestions. Should you have any questions, please feel free to contact our Business Taxes Committee staff member Mr. Michael Patno at 1-916-323-9676, who will be leading the meeting.

Sincerely,

Susanne Buehler, Chief  
Tax Policy Division  
Sales 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  
Mr. David Hunter, 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. Alan Giorgi, Board Member's Office, First District  
Mr. Brian Wiggins, 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  
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Mr. Ted Matthies, Board Member's Office, Fourth District  
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Mr. Wayne Mashihara (MIC 46)  
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)  
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Mr. Lawrence Mendel (MIC 82)  
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Mr. Marc Alviso (MIC 101)  
Mr. Chris Lee (MIC 101)  
Ms. Laureen Simpson (MIC 70)  
Ms. Karina Magana (MIC 46)  
Mr. Bradley Miller (MIC 92)  
Mr. Bill Benson (MIC 67)  
Mr. Robert Wilke (MIC 50)  
Mr. Michael Patno (MIC 50)

# INITIAL DISCUSSION PAPER

## Proposed Amendments to Regulation 1668, *Sales for Resale*

### Issue

Whether the Board should amend Regulation 1668, *Sales for Resale*, to interpret, clarify, and make specific the recent legislation regarding sales and purchases of counterfeit goods.

### 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 suggested regulatory language for proposed rulemaking.

#### General

The Revenue and Taxation Code (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 in good faith from a purchaser a resale certificate 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

The passage of AB 2681 on September 14, 2014, amends RTC §6007 and creates RTC §6009.2, making all sales and purchases of counterfeit goods subject to tax, including claimed sales for resale. The bill's changes take 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.

# **INITIAL DISCUSSION PAPER**

## **Proposed Amendments to Regulation 1668, *Sales for Resale***

### **Sales and Purchases Involving Counterfeit Goods**

Prior to the passage of AB 2681, a person found guilty of selling counterfeit merchandise could claim qualified transactions as sales for resale. In addition, inventory found in the possession of a convicted purchaser was not subject to tax.

AB 2681 makes any sale or purchase of merchandise with a counterfeit mark taxable if the person selling or purchasing the counterfeit goods is a convicted seller or purchaser. This is regardless of whether the person is the manufacturer, wholesaler, distributor, or retailer of the 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 has proposed to add subdivision (j), *Counterfeit Goods*, to Regulation 1668. The language will clarify that a convicted seller is unable to claim their sales of counterfeit goods as nontaxable sales for resale. It will also clarify that purchases of counterfeit goods by a convicted purchaser are now subject to tax. (See Exhibit 1).

### **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 would 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 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 insertion is in keeping with the existing exceptions for mobilehomes and mobile transportation equipment which are referenced in subdivisions (h) and (i), respectively.

### **Non-Substantive Revisions**

In addition to the proposed amendments regarding counterfeit goods, staff proposes non-substantive amendments. Most of these revisions are to address grammatical errors within the regulation. Staff also proposes to delete an effective date reference in subdivision (h) which is no longer relevant.

### **Summary**

Staff proposes amendments to Regulation 1668, *Sales for Resale*, to clarify AB 2681 and the corresponding amendments to RTC §6007 and creation of §6009.2. Staff welcomes any comments, suggestions, and input from interested parties on this issue. Staff also invites interested parties to participate in the June 2, 2015, interested parties meeting. The deadline for interested parties to provide written responses regarding this discussion paper is June 17, 2015.

**INITIAL DISCUSSION PAPER**  
**Proposed Amendments to Regulation 1668, *Sales for Resale***

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 05/21/2015

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**§ 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,”* 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, 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~~)-(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 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 [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.

(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~~ Also, 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.