

BOARD OF EQUALIZATION

In the Matter of the Petition)	
for Redetermination of State and Local)	DECISION AND RECOMMENDATION
Sales Tax and Transactions Tax;)	OF HEARING OFFICER
)	
G--- E--- C---, INC.)	Account No. SZ -- XX XXXXXX
dba P--- L--- C---)	
)	
_____)	
Petitioner))	

The above-entitled matter came on regularly for hearing on Wednesday, September 18, 1974 at 2:30 in Hollywood, California.

Appearances:

For Petitioner:	Mr. R. C. R---, Accounting Manager
	Mr. W. G---, Accountant

For Board of Equalization:	Mr. F. P---, Auditor
	Hollywood District

Protest

Pursuant to an audit covering the period from 04-01-70 through 03-31-73, and a determination issued on January 28, 1974, Petitioner protests the assessment for sales tax on amounts retained from selling price of merchandise that was returned and which is claimed as restocking charges or costs. The measure of the assessment is \$115,449.

Contentions

Petitioner has been audited every three years and the method of handling and computing restocking costs has not changed, however, the methods were acceptable in prior audits.

Petitioner has complied with Regulation 1655 in refunding to customers the entire selling price, including sales tax, when merchandise is returned for credit.

Restocking charges do not exceed the actual costs of restocking.

Summary of Facts

Petitioner is a corporation with its home office located in the State of New York. The business consists of sales of electrical supplies and appliances at wholesale as well as retail.

This controversy arises as a result of the way Petitioner computed and charged customers for restocking merchandise that had been returned and the fact that the auditor concluded the Petitioner's way of computing the costs of restocking merchandise was not in accordance with the provisions of Regulation 1655.

Petitioner's representatives explained that, for the most part, the only time a restocking charge is deducted from amounts returned to customers who return merchandise is when the item or items returned are not those which Petitioner ordinarily carries in stock and which are therefore returned to the supplier by Petitioner.

Mr. R--- stated that where merchandise is of the type that G--- ordinarily stocks the customer is not charged anything for restocking.

Items that are not ordinarily stocked by Petitioner are shipped directly from the supplier to the customer. If the customer made a mistake in his order and wants to return it, the goods are returned to Petitioner who, in turn, sends them back to the supplier. It is the exception rather than the rule where goods are returned by the customer directly to the supplier.

Mr. R--- notes that almost all of the returned merchandise items questioned by the auditor were those arising out of mistakes in ordering made by customers and which were ultimately sent back to the supplier. He stated that since these are not stock items there is a great deal of handling involved.

First of all, most suppliers require Petitioner obtain a "return authorization" from them before they will accept returned merchandise, and this is time consuming because it involves additional paperwork.

In the meantime, the customer wants to get rid of the merchandise and receive credit on it. Thus, the customer returns the merchandise directly to Petitioner, usually freight collect. Petitioner receives it in its warehouse, processes the credit to be allowed the customer, places the merchandise in a special "assemble and hold" section of the warehouse and awaits the authorization from the supplier whereby the goods will be returned to him. Suppliers make a charge to Petitioner for merchandise that is returned which is passed on to Petitioner's customer.

When authorization is received, Petitioner ships the goods to the supplier and prepays the freight as all suppliers require this where goods are being returned due to errors in ordering made by customers.

There is handling by Petitioner which has its costs, two freight charges (one from the customer to Petitioner when goods are shipped collect, and another paid by Petitioner to ship the goods back to the supplier) plus the restocking charge levied by the supplier.

The auditor disallowed the credits for returned merchandise claimed for the following reasons:

1. Restocking charges were deducted and they were in excess of the amount the supplier charged Petitioner for restocking.
2. Sales taxes refunded to the customer were computed on the net credit after deducting the restocking charge.
3. In some instances, freight charges as well as restocking charges were deducted from the credit given to the customer even though the merchandise was sold on a delivered price basis.
4. Some of the returns disallowed involved credit memos where a restocking charge was made even though the credit memo did not indicate a charge from the supplier.

The audited liability was computed using a test period consisting of the months of August 1971, June 1972 and February 1973. The auditor determined that .14 percent of the Los Angeles District taxable sales represented improper credits netted for returned merchandise. This figure was then used to compute the measure of disallowance.

Conclusions

Section 6012 of the California Revenue and Taxation Code provides, in part, that:

Gross receipts do not include the sale price of property returned by customers when the full sale price is refunded either in cash or credit, but this exclusion shall not apply in any instance when the customer, in order to obtain a refund, is required to purchase other property at a price greater than the amount charged for the property that is returned. For the purpose of this section refund or credit of the entire amount shall be deemed to be given when the purchase price less rehandling and restocking costs are refunded or credited to the customer.

Regulation 1655 (Returned Merchandise) provides, in part, as follows:

The amount upon which tax is computed does not include the amount charged for merchandise returned by customers if (1) the full sale price including that portion designated as "sales tax" is refunded either in cash or credit....

Section 6054.5(a) provides:

"When an amount represented by a person to a customer as constituting reimbursement for taxes due under this part is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid shall be returned by the person to the customer upon notification by the Board of Equalization or by the customer that such excess has been ascertained. In the event of his failure or refusal to do so,

the amount so paid, if knowingly computed by the person upon an amount that is not taxable or is in excess of the taxable amount, shall constitute an obligation due from him to this state.”

The audit report and the petition for redetermination raise two issues which are:

1. Has Petitioner refunded the full sale price of the property, less rehandling and restocking costs, and
2. What is the effect of failure to refund the entire amount denominated “sales tax” on the original invoice?

1. Refund of the Full Sale Price

The tax (sales tax) is on the retailer and any amount of sales tax reimbursement which is separately stated is itself a part of the purchase price. De Arvan v. Akers (1939) 12 Cal.2d 781, cert. den. 308 U.S. 581.

Thus, where the law says the full sale price is to be refunded, it means that amount that represents sales tax, too.

The regulation spells out what the law says with reference to “full sale price.”

The deduction from the full sale price is limited to the actual cost of retaking and restocking the returned merchandise, and appropriate records must be kept by the taxpayer to show how the charge was arrived at. (“California Business Taxes Law Guide, Sales and Use Tax Annotations, annotation number 490.0140.) In determining whether the rehandling and restocking costs equal or exceed the amount retained by the seller, these costs are to be determined on a transaction-by-transaction basis. Each transaction must be considered by itself and costs may not be averaged. (Annotation number 490.0160.) Charges to a retailer by a manufacturer of special order merchandise returned for credit by the retailer’s customer should be regarded as a part of the retailer’s restocking and rehandling costs. (Annotation 490.0260.)

Generally, the direct costs (excluding “overhead” and reconditioning) of any action which is a specific step in the sequence of actions occurring in the retaking of the returned goods and their return to the suppliers are properly included in rehandling and restocking costs. This would include, where applicable, the costs to Petitioner for the customer’s request for authorization to return the merchandise, the freight paid by Petitioner for the return of the merchandise from the customer to him, placing the merchandise in the “assemble and hold” area, obtaining authorization from the supplier to return the merchandise, sending the merchandise to the supplier, and issuance of credit memo to the customer. These costs are illustrative and are not necessarily all inclusive.

Since the Petitioner has not retained records of all costs, an estimate may be made of those which are common to all returns. To this may be added those costs which vary from transaction to transaction, i.e., freight from customer to Petitioner, freight from Petitioner to supplier, and amount charged Petitioner by the supplier.

To determine whether Petitioner refunded the full sale price to the customer, the total of Petitioner's costs, as determined in the above manner, should be compared with the amount Petitioner charged the customer. This should be done on a transaction-by-transaction basis. If in any transaction Petitioner charged the customer more for the return of the merchandise than Petitioner's costs, the returned merchandise deduction is not allowable with respect to that transaction.

2. Failure to Return the Full Sales Tax Reimbursement

The fact that Petitioner has not refunded the entire amount designated on the original sales invoice as "sales tax" does not require disallowance of the returned merchandise deduction. As pointed out above, sales tax reimbursement is a part of the sale price and should be considered as such in determining whether the full sale price is refunded. When the returned merchandise deduction is otherwise allowable, but the full amount designated as "sales tax" is not refunded, then the retailer has collected excess tax reimbursement and Section 6054.5 applies.

This may be illustrated as follows:

<u>Sale</u>	
Price	\$100.00
Sales tax @ 6%	<u>6.00</u>
Total	\$106.00
 <u>Return</u>	
Price	\$100.00
Less 25%	<u>25.00</u>
	75.00
Sales tax @ 6%	<u>4.50</u>
Amount refunded	\$ 79.50

Assuming the actual costs to the retailer of retaking and restocking the merchandise is \$30, the amount charged the customer is \$26.50. The returned merchandise deduction is allowable, but the retailer has refunded only \$4.50 of the \$6.00 tax reimbursement charged. Thus, the retailer has collected \$1.50 in excess tax reimbursement which must be refunded to the customer or paid to the Board. If the excess reimbursement is not refunded the returned merchandise deduction allowable in the example is limited to \$75.00.

Recommendation

Hollywood auditing will prepare a reaudit in accordance with the above conclusions.

Robert H. Anderson

Robert H. Anderson, Hearing Officer

FEB 3, 1975

Date

Reviewed for Audit:

J. A. Najarian

Principal Tax Auditor

Feb. 13, 1975

Date