

Brokers May Be Held Liable for Sales Tax

During a recent discussion with a business owner, he told me he was not required to have a seller's permit because he was a broker and not a dealer. He said he called the California State Board of Equalization (Board) and they advised him he didn't need a permit.

I researched laws and regulations and discovered that a definition for retailer is clear. The definition for broker is not. I called the information number at the Board and asked for an answer. The reply was, "It's simple, it's a matter of title. It's just like a real estate agent. If the dealer actually owns the inventory, he's a retailer. However, if he merely puts together two people and takes a commission, he's a broker and is not responsible for collecting the tax."

I referred the auditor who answered my question to several previous Board opinions that conflicted with what he said and he admitted the answer was not clear. I found cases where it primarily mattered whether the broker-dealer had control over the sale.

California Sales & Use Tax Annotation 185.0080 states in pertinent part:

"When a yacht owner signs the bill of sale, and gives it to the broker authorizing him to sell at a stated price, the owner has invested the broker with power to create an ownership interest in the purchaser. The broker becomes liable for the sales tax upon the consummation of a sale through the exercise of such power."

Annotation 185.0100 states in pertinent part:

"Where an airplane dealer aids a prospective purchaser in locating and purchasing an airplane from a third party by locating a willing seller, having the plane brought to his place of business, or aiding the buyer in examining the plane and in addition obtains financing for the buyer..."

Annotation 185.0120 states in pertinent part:

"The liability of a yacht broker does not depend upon whether he holds an exclusive or an open listing. It depends rather upon whether he has the right to beneficial use of the boat or the power by his own act to vest ownership in another."

As you can see the broker-dealer never took title. In these cases a business that thought it was acting as a broker and may have gotten advice from the Board that it didn't need a permit, could later be found to be liable as the retailer and as such be responsible for the sales tax.

I asked the auditor, "If I am a new aircraft or yacht business and I call you to find out if the Board requires me to have a permit, what do you do?"

"We ask you whether you are a broker or a dealer. How does the Board define the difference?"

He said, "We will ask you to put your specific questions in writing and we will give you a written answer that may afford you protection you under Section 6596 of the Revenue & Taxation Code."

This section of law may relieve you of liability if you received written instructions from the Board and you followed them. This only works if you asked the right questions when making the inquiry.

If you call yourself a broker when you talk to them, they will advise you that you don't need a permit. Every industry that exists has a tendency to mix and match its nomenclature. We have all experienced two people in the same business who use the exact same term to mean different things. How many times have you heard the term broker and dealer incorrectly used interchangeably?

It is very simple for business owners to believe that all they have to do when they need an answer is ask the Board. When the Board tells them they don't need a permit, most business owners breathe huge sighs of relief and move on to the important things like sales, marketing, customer service and finance.

The Board doesn't have a policy of purposely misleading the public. It doesn't have the time to research every customer's real business profile. It's your responsibility to research all the rules and regulations to defend your decisions, not theirs!

Just because you think you are a broker and the Board told you that a permit was not required doesn't protect you from an audit. The Board will periodically check who is advertising and cross reference with their list of businesses who have a permit. They can come across your name because they audited the reciprocal party to your transaction. There are as many ways to find out about you as there are tax auditors.

The good news is, if you have been audited in the past under this type of circumstance and the auditor found that you are classified correctly as a broker and that you are not liable to collect the tax, hold on to the audit papers. Under 6596, even if a different auditor wants to assess you tax, the prior audit papers can be your defense. Regulation 1705 was approved recently to include prior audits and paperwork from the Board as written communications on which you can seek relief.

The bad news is, because the definitions are not precise, a subsequent auditor can assess you tax. Because you may have told the Board you were a broker when you asked the question about needing a permit, you can't rely on their advice. The reason the auditor working on the information line told me that you had to send in the request in writing is that the exact terms you used when you asked the question can become the Board's defense for their answer to you.

The catch-22 is that you don't know all the laws or even have access to them in a simple format. The likelihood is fairly high that the Board can decide that you left out a significant detail when you requested their opinion.

I found a section in the Field Audit Manual that gives you an idea of what danger you may be in. Under section 0601.45 it says, "There are no guidelines which will enable the auditor to determine in which capacity the broker is acting in every situation. Each transaction must stand on its own merit." This means two different auditors can come up with entirely different assessments. Both can read your contracts and invoices and come up with different interpretations.

You should have a professional sales tax expert review all of your forms, brochures and what your sales pitch is to your customers. All of these can be used against you when it comes to making you liable for the tax. Accountants and attorneys without specific knowledge of sales and use tax may be more harm than help.

Remember that when you are dealing with the Board over a dispute, they are the judge, jury and the executioner. Don't try to go through the process without professional help.

-- Thomas A. Alston